Challenge

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letters TO THE EDITOR

Challenge invites your comments. Address letters to CHALLENGE, *475 Fifth Avenue, New York 17, N. Y.*

School term

•Mr. Strayer is right [*The Need for Fruitful Conflict*, October, 1958] when he says that no effective action has been taken to remedy the shortcomings of our schools. It would seem that the shock of the sputniks has worn off, and our legislators will resume turning an indifferent ear to talk of educational reform. Realizing they've milked the "sorry-state-of-schools" issue of all its publicity worth, the so-called experts have migrated to other controversial areas where headlines are more abundant. Since October, 1957 this country has completed a cycle in self-appraisal–from irrational self-complacency to irrational self-doubt to irrational self-complacency. When will we realize that long-term problems cannot be forgotten as soon as they become less newsworthy?

CHESTER DOMERACKI

Ann Arbor, Mich.

Diversion?

•While no one could disagree with Mr. Witte's statements [*Is the Social Security Fund Solvent?*, August-September, 1958] that our social security system has, up to now, been a self-financed system, I think he misled many readers by stating that:

"Every dollar collected for old age, survivors' and disability insurance has been used for this purpose only. Hard pressed as the government has been to balance its budget, it has never been proposed that the old age, survivors' and disability insurance funds be diverted."

In actual practice, almost half of the 23-billion-dollar reserve fund has been diverted to meet general government expenses, and the fund consists of a bunch of IOU's issued by the Treasury. If the fund had not been available for Treasury use, the government would probably have had to go to the regular markets to finance the public debt.

I am surprised that Mr. Witte oversimplified this aspect of the matter, and am even more surprised that CHALLENGE let it go through.

EDWARD W. STEPNICK

Silver Springs, Md.

What I assume troubles Mr. Stepnick about the financing of the O.A.S.I. system is that the reserve funds are invested in government securities. So are a large part of private insurance companies' and all other United States trust funds'

reserves. This method of trust fund investment was first developed when Andrew Mellon was Secretary of the Treasury, and has been found to be sound by every group which has studied the subject. The only possible alternative is investment of reserves in private enterprise–which would be a long step toward the socialization of industry.

EDWIN E. WITTE

Quest

•Your suggestion in *A Personal Note* [August-September, 1958] that "the time is ripe to get excited about making some improvements in our economic system" is particularly appealing. But where will we find the economic theorists who will climb down from their pet fancies and help find these improvements? Who of the institutional economists will jeopardize his position by giving priority to the macroeconomics of the whole nation over the microeconomic interests of his boss? What educational institutes would be willing to devote their efforts to evaluating these new goals? Finally, what publication would give these ends sufficient publicity?

SAMUEL M. ESLER

Denver, Colo.

Uneconomic man

•I particularly enjoyed Mr. Dallin's comments [*The "New" Communism*, October, 1958] on Yuri Larin's life and personality. Many of your theoretical and analytical articles would come to life if a little more historical, social and cultural data were injected into them. Economics is a subject that involves human beings; and a preponderance of abstractions and statistics too often obliterates that fact. Certainly, your personality profiles are a step in the right direction.

HOWARD ATTLEY

Braddock Heights, Md.

Classical Economics

•You talk of the "New Capitalism" in your October issue. Capitalism it is, but where do you get that *new* stuff? It is the same old thieving, cut-throat, imperialist system it has always been; only now the U. S. has replaced England as the leader of the gang of thieves.

EUGENE SMITH

Granger, Wash.

Terse I

•Your bristling reviews are admirable examples of terse writing. But why do you comment on so many mediocre works? Either the bulk of current social science literature is abominable or your editors have made some extremely poor selections.

JAMES DECKER

Haverhill, Mass.

Terse II

•I have taken CHALLENGE and many other publications in the hope of obtaining guidance on the confusing problems of our time. But the best of these publications makes thinking even more involved. Your articles seldom deal with actual problems, and are merely academic discussions.

GORDON LOWDEN

Chicago, Ill.

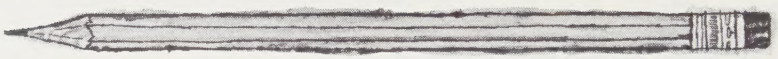
Terse III

•Congratulations on your October issue! It is the first one that I really enjoyed from cover to cover.

RALPH L. PARLETT

Ellicott City, Md.

a personal note



from the editor

Can there be real economic issues?

■ ONCE UPON A TIME stock prices used to be an unfailing barometer of how the business community viewed the results of a nationwide election. If the Republicans emerged as a significant majority, prices moved up immediately. If the Democrats won, as they did recently, then prices slipped, reflecting the business world's apparent pessimism over future prospects. This, at least, was the way stock prices used to act. This year, however, prices on the stock exchanges hardly noticed the Democratic majorities, and one week after Election Day, prices hit a new high. What significance can be found in this strangely insensitive behavior of a formerly reliable barometer?

For one thing, I suppose it is safe to assume that the overwhelming majority of investors does not expect significant reductions in its future returns because the Democrats are in firm control of Congress. Is this a new-found faith in the political party that some have termed "the party of big government, big spending and deficit financing?" I think not. Most stockholders who in the past looked askance at the alleged fiscal irresponsibility of Democrats still individually feel the same way about the Democratic party. But as a collective lot, stockholders have come to believe what everyone else in the country now believes–namely, that no matter which party is in control of Congress, of the White House, or of both, this nation just will not stand for any downward movement in anything, except possibly prices, and this only if nothing else goes down. And so we are forced to conclude that in a very real sense the economic issues between the two parties have been almost completely reduced to differences of opinion on procedural questions. The very basic substantive questions no longer seem to be open to debate and are the subject of some curiosity to only the extremists of both parties who apparently no longer have enough strength to influence the outcome of an election.

Now, there might be some people who will deplore, or who have

already been deploring for some time, this lack of imaginative controversy between the two parties in the economic area. I frankly do not know whether this is a good or bad thing. One might say that there is so much room for controversy over foreign policy issues, civil rights and the like that it is a relief to find a political consensus on something. But it is only fair to point out that if the Democratic and Republican parties are not exactly poles apart on some of the most basic issues of economic behavior in this country, it is because circumstances and the American people have forced them into such a narrow arena that they can hardly tell themselves apart, let alone delineate the distinctions which might separate them.

It behooves us to take a look at the aforementioned "circumstances." They can be boiled down to two words: cold war. The cold war is a postwar phenomenon of both inescapable proportions and of indeterminate length. All basic issues between the two parties relating to taxes, budgets, fiscal administration and money management have the aura of unreality about them as long as the entire complex of defense expenditures exist. How long defense must be paid for is not known. How much it might ultimately cost is not known. Even the specific goals to be attained by the expenditure of human, material and financial resources are subject to change, and therefore we cannot condition ourselves to any set pattern or pace. The only sure thing is that the cold war must be fought. In these circumstances, differences between the two parties wither away in the forge of necessity and with the ultimate responsibility to survive, whatever the cost.

The other contributor to the narrow arena into which the political parties have been forced is the American people, as mentioned above. Now, it is undoubtedly true, in spite of all the talk about conformity, the desire to be alike, groupism, etc., in terms of individual wants, needs and expressed opinions, the American people remain the most diverse lot on earth. The citizen of the U.S.A. has not surrendered his right to express his unique opinion on the "how" of his desired economic goals. But the "what" of his goals is no longer debatable, at least as far as the vast majority is concerned. The "what" has been inscribed into law and placed on such a high pedestal that no one can fail to see that it is there and feel reassured thereby. The Employment Act of 1946, however qualified its terminology, is interpreted as a guarantee against gross economic malfunctions. This, too, is a permanent commitment which neither party can disavow. What else can they do but sound different and act alike?–H.B.

Challenge Notes

The Soviet Seven-Year Plan; money and influence; inflation: psychological and economic; glamorous propaganda

■ JUDGING FROM her past record, the Soviet Union is fully capable of realizing most of the goals (in particular the 80-per-cent increase in gross industrial production) set by her recently published Seven-Year Plan. This time even the experts believe that the Soviets can do it.

While it is true that even the contemplated 80-per-cent increase in industrial production is well below *last year's* U. S. output, this fact does not warrant complacency. Soviet statistics are admittedly tricky, and a great deal is "purposely hidden." Even so, we do know that about three-fourths of the Soviet Union's industrial output consists of "means of production"–factories, machinery, armaments, etc. While it is difficult to establish comparable definitions for the U. S., most economists would agree that not more than one-third of our industrial production is devoted to the same end.

In terms of military strength and long-run capital accumulation, this allocation of resources is clearly extremely important. The Soviet Union's emphasis on capital goods gives her an important advantage in realizing the objectives of an expansionist foreign policy.

The planned investment outlays to finance the objectives of the Seven-Year Plan indicate that there will be no significant shift from the emphasis on capital goods. The planned rate of increase for heavy industry is between 85 and 88 per cent, while the planned increase for consumer goods production is only between 62 and 65 per cent. While Khrushchev has promised the Soviet workers a 40-per-cent increase in real income by 1965, it is difficult to see how this can be accomplished within the framework of the Seven-Year Plan.

On the other hand, some improvement in living standards is certain. And in the Soviet Union even a little more butter should help, as Khrushchev observed, to make better Communists. Certainly, the West cannot count on po-

litical unrest to diminish the challenge posed by this latest Seven Year Plan.

Tool or captive?

Is the Republican party a "tool" of big business? Is the Democratic party a captive of labor unions? Elections have been won (and lost) because the voters had been convinced the answer was "yes."

Old myths die hard–especially when they have some foundation in fact. Since about 90 per cent of the money spent on political campaigns is provided by about one per cent of the eligible voting population, it is obvious that the financial backing of American parties is very narrow. But if political parties must lean heavily on the support of a few generous individuals and institutions, the fault does not lie with the parties, but with the rest of us who do not contribute to their upkeep.

Moreover, last month's election returns indicate that financial dependence is not at all the same thing as control over policies. Never before had business been as active in politics, or unions as generous with their time, money and organizational skills. The result was a remarkable showing of voter independence. Except for the so-called "right-to-work" laws, there were no clear political issues between business and labor. Even so, organizational endorsement of candidates played an extremely small role in their election or defeat. Judging by the returns, Americans are rather less institutionalized in their political decisions than many worriers over the "new capitalism" are willing to concede.

A key issue

Inflation is both an economic and a psychological reality–and right now it is the psychological impact of inflation that is making itself felt. While many economists speak (perhaps a little overoptimistically) of a brief breather from inflation, even a relatively stable cost-of-living index is too high when one is unemployed or when one's pay check is smaller. That is why inflation will be a key political issue when Congress reconvenes next January, and that is why the chances are good that more than just talk will emerge from the political debates.

Glamorous propaganda

The poets' division of the Soviet Writer's Union is being enlisted in a nationwide campaign in Russia to create ads that are "truthful, concrete, eye-catching, easy to remember and varied." Such ads will not be "glamorous, deafening, capitalist propaganda." One man's gamorous propaganda is another man's unglamorous ad.–M. K.

by Nathan Glazer

The sorrow of our cities

Their explosive growth has made cities outrun both cultural and technical needs

■ THE CITY has been many things in history: fortress, religious center, political and administrative capital, center of culture, style and thought, place for the production of goods, node of transportation networks. The city today is that and much more: it is now the place where most people live and will soon be the place where almost everyone lives.

This is a new fact in history. Before the 19th century, 90 per cent of the people in the most civilized countries did not live in cities. They lived in villages and farms. Cities were small; they were places where very special people lived: kings, noblemen, priests, rich merchants, skilled artisans and foreigners.

It is not surprising that we should find the older cities beautiful. They were the places where all intelligence, beauty, taste and power were concentrated. Even if plumbing was defective, there was an obvious *concern* in their design. The houses were distinguished because distinguished people lived in them; the streets were often carefully planned because they linked palaces and great churches, and the parks were beautiful because they were designed for people of quality. Morover, the countryside was easily accessible.

The Industrial Revolution meant an urban revolution. When it became profitable to bring large numbers of people together, the city became an important center of production. It became devoted

not to the small-scale production and sale of luxury goods, but to the production of necessities for the great mass of the population. Industry sprang up in favorable locations, and for the first time cities existed in which most of the houses had been built to shelter the poorest part of the population.

The cities also became great administrative centers, as the modern state grew and as the bureaucracies of state and corporation proliferated. The process is by no means at an end: the cities and their suburbs grew and continue to grow far faster than the static farms and small towns. From 20 per cent of the people in the cities in 1860, we move into an age with 60 per cent in the cities in 1950–and the proportion will certainly go higher.

Linked developments

This is the first of a series of linked developments that have created the incredible problems of modern cities. The second is the population explosion contemporaneous to city growth. The population of the nation doubled between 1900 and 1950 while the city population more than tripled. By 1975, there will be 225 million Americans and a much greater percentage of them will live in large cities.

But this is not all: the rise of the automobile has meant an enormous increase in the physical size of cities. It now becomes possible to live at much greater distances from the centers of cities and still be part of them. The plot for the average American house is much larger than in the days of trolleys when one had to be near transportation lines. And the rise of the automobile produces a vicious circle in which the population diffusion makes public transit uneconomic, causes a decline in public services and forces more and more people to resort to cars.

The result is a fantastic variety of problems. Political problems are caused by the fact that jurisdictions cannot possibly match the actual extent of urban areas. New facilities are extremely expensive. Recreation becomes a logistic problem caused by the need to travel great distances to get to open land. The heavy dependence on cars requires enormous expenditures on roads, bridges and parking lots. Then there are problems caused by problems; the difficulty of housing vast multitudes has produced such vast solutions as the monstrous low-cost housing. Experts predict that these developments will breed massive problems in terms of urban disorder.

There is an order of problems perhaps more important than the practical–the problems of quality. We are still hardly aware of what is lost when New York City ex-

plodes from its 1900 population of 3.5 million to a metropolitan population of 15 million today. The city no longer contains so high a concentration of talent, wealth, power and art. When the city existed for court, church, nobility and wealthy merchants, it offered an atmosphere of excitement and supported a degree of creativity that the contemporary city, devoted to the workaday life of society, cannot possibly equal. American cities are now the place where everybody–not only the distinguished, the eccentric and the notorious–lives. The city has become an ordinary place, and it suffers the consequences of the concentration of ordinariness. European cities, which still have centers which were built when the city served these cultural functions, are rather better off. Furthermore, only a very few of our cities have any large groupings of talent, while the rest might as well be villages.

Vast bedroom areas

The quality of city life has also been affected seriously by the need for vast residential quarters for the lower and lower-middle classes, and they inevitably cannot have the richness–in variety of building types, human types, institutions–that a city which existed as a special center could have. In the 18th century there were no Brooklyns; the people who would have lived in these areas were in the countryside.

The suburbs–vast bedroom areas –introduce a different quality of life, one that is neither urban nor rural. The great attention now being given them reflects the general awareness that they are really quite unique historically. By contrast with the suburb, even the factory quarters of the 19th-century town seem to have had certain advantages. Of course, most people would not exchange the more spacious house and other advantages for factory quarters. Yet we may learn something that will help us in the visual and social design of such residential quarters if we consider the 19th-century industrial town. The factory and its town were related to central aspects of nature, economy and society: the railroad and river were there, the owner and the executives lived perhaps on a nearby hill. The factory town was a meaningful miniature of society.

In the present-day suburb, all reference to nature is so altered as to be hardly visible. The trees are from a nursery, the hills have been bulldozed away, all sense of place and uniqueness is gone. Reference to the structure of society is also absent: the suburb is very often of one economic class, and there is no visible means of livelihood for miles around.

This unsatisfying relationship to nature and society is not an inevitable consequence of city growth, but it would have required a serious planning effort to counteract these effects. For, inevitably, as we increase *scale,* we reduce *variety.* A town or city must have schools, churches and a variety of services. In our large cities, these institutions reach tremendous size and are cut off physically and socially from their surroundings. Planning for variety must replace what used to come naturally on a smaller scale. It must struggle against the fact that there is nothing simpler than to level an enormous tract and set up 12,000 houses. The result is a social horror.

Question of quality

The question of quality in city life will increasingly dominate the discussion of city problems. In an economy of scarcity one can allow a single criterion to dominate one's approach to human problems: productivity, or more generally put, the need to keep alive. In such a society, an attack on a housing form because it is ugly seems the merest dilettantism. What alternatives, it is asked, do you have to Levittown or 21-story low-rent housing projects? Can you house as many people as cheaply? Probably not. But this country can afford almost anything. It makes the most incredible expenditures to permit a few motorists to save a few minutes. Obviously the matter cannot long be debated on economic grounds alone; we are a rich country and have choices.

We see the first breakthrough into a concern with quality in recent urban renewal and redevelopment proposals which articulate a desire for urban grandeur and beauty. Unquestionably direct economic interests have been primary. But one sees examples where one economic interest overcomes another, because it has on its side the argument: "This will make our city more beautiful, more grand, more interesting."

Is it really possible to think now in terms of the traditional city? Indeed, many advanced thinkers do not, and most of the present building activities serve not to restore this traditional city but to create quite a different one. The new city can scarcely be called a city; it becomes something intermediate–not city, not country. It has great roads, vast housing developments and huge shopping centers scattered at random over an enormous area. There are no great points of concentration or density. Where the city once was, there is the surrealistic crossing of many roads on many levels, and perhaps a few office buildings and cultural institutions modeled on

the shopping centers and surrounded by enormous parking lots. These special-function areas are deserted except for the time of day when they perform their particular function. Yet I describe what many Americans regard as a utopia.

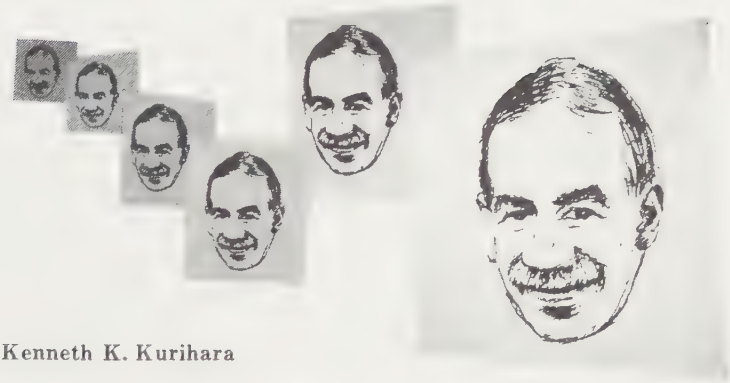
What is lost? The loss is clearly felt by *some*–that part of a nation which formed the majority of the old city's inhabitants. That part needs human contact and seeks a variety not dependent on placing every activity between the parentheses of a car ride. A few vestiges remain. Broadway is still concentrated enough to permit people to transact their business without the aid of private motor vehicles. The same is true of the Wall Street area, the new executive office section of Park and Madison Avenues, and Greenwich Village. The fact that the weakening of such city concentrations is felt as a loss by only a minority does not mean that the loss is any less real.

Individual spontaneity

But I must confess I cannot see how the processes that are creating this city of the future are to be slowed down or reversed. This is not a counsel of pure despair. The traditional city, even as it declines, can teach us things about making this new city or urbanized region more bearable. If we desire variety, then we can no longer depend on natural forces to create it. We must consciously introduce it; planning a varied subdevelopment for 50,000 people is far more demanding of time and intelligence than building the same house ad infinitum. It means we have to consider just what kind of variety we want, how we can introduce it and where we can leave room for individual spontaneity in building within the over-all plan. If we want rural land near our cities in a relatively undeveloped form, we must consciously maintain it by buying up great tracts and insisting they must never be developed, tracts which will have the same loyal defenders as Central Park in the middle of New York does. If we want areas where we can forget about our cars, walk and be exhilerated by a variety of urban experiences and sights, we must be prepared to protect, as we protect our national parks, some of our more successful urban areas. We must do it even though they are crowded, messy and traffic bottlenecks.

Perhaps America, even as great stretches of it are turned into urbanized regions, is rich enough to maintain, and even develop, cities of a different sort and capable of offering the physical and social environment which has meant so much to human beings in the past. ■

beyond Keynes



by Kenneth K. Kurihara

Economic thought has been revolutionized by Keynes, but even his most ardent followers insist on modifications

■ LORD JOHN MAYNARD KEYNES' *General Theory of Employment* was a great advance over the classical assumption of automatic full employment. It was also an improvement upon the preoccupation of neoclassical economists with "frictional unemployment." With Keynes (1883-1946), unemployment ceased to be looked upon as a sentimental curse to be resented by any particular economic class and began to be regarded as an avoidable waste of over-all economic resources. His theory is generally considered adequate in explaining the kind of mass unemployment which arises when investment is periodically weaker than saving. That full employment should be provided by design is a commonly accepted principle among democracies today, for they have found much that is congenial in a diagnosis of mass unemployment aiming at curing the disease "whilst preserving efficiency and freedom." Few would doubt Keynes' influence over Britain's 1944 White Paper on Employment, America's 1946 Employment Act or the United Nations' 1949 *National and International Measures for Full Employment.*

However, Keynes' theory of employment is not without its inadequacies, nor are his full-employment policies without their difficulties. First, his theory fails to explain that other kind of unemployment common to underde-

veloped countries which arises from the shortage of capital relative to the growth of population. This "structural underemployment" is different in basic character from the "cyclical unemployment" which was the major concern of Keynes. Second, it does not provide an explanation of "technological unemployment" in a dynamic economy where labor-saving devices and automation may grow faster than job opportunities, and less and less labor is required per unit of output.

Linear equation

Keynes' savings-investment theory of business cycles is far from complete, moreover, to the extent that the volume of employment is accepted as the best single index of economic activity. The Keynes theory was actually very simple and could be expressed in what the mathematicians called a linear equation. The theory posited a constant relation between investment and employment; if investment went up or down, employment would go up or down in the same proportions throughout the boom-depression cycle.

Post-Keynesian writers exploded the elegant simplicity of his formula with their "nonlinear" theory. This introduced such investment-depressing elements as labor and raw material shortages, high production costs and excess capacity. It also brought in such economic stimulants as low production costs, equipment obsolescence, short capacity, competitive innovation and inventory liquidation. The importance of these depressants and stimulants is that they change the link between investment and employment from a constant to a variable relation, depending on where the economy is situated on the boom-depression cycle. Thus, if the economy had excess capacity during a boom, investments would be held back, although they would normally–according to the Keynes linear theory–be encouraged by rising business activity and employment. Similarly, short capacity might evoke more investments during a depression.

One aspect of post-Keynesian nonlinear theory is in seeming contradiction with a classic Keynesian postulate. Keynes himself deprecated monetary policy in the type of depression he studied in his *General Theory*. He did this because, among other things, he saw the investors as being so affected by the depression that changes in interest rates would make little or no changes in their investment plans. Post-Keynesians, however, emphasize monetary as well as fiscal measures in countercyclical policy. If a raw material shortage places strains on the economy or if demand for consumer durables is depressed,

they might advocate governmental action–easier credit, for example–that would bring this nonlinear factor into line.

The theoretical contradiction between Keynes and the new generation of economists, however, can be resolved by referring to the context of economic reality. He was writing his *General Theory* during a depression so severe that it arrested or suspended "normal" responses by the economy. Since that time, the Western economies have been sufficiently healthy to respond to changes in monetary-fiscal policy. If the post-Keynesians have modified the savings-investment theory, they have also strengthened it as an explanation of changes in the business cycle by reference to cyclical variations in investment or consumption.

Design–not accident

Given a universal determination to provide full employment by design instead of leaving it to accident, greater attention may have to be paid to the problems of price inflation than Keynes was himself inclined to do. First, Keynes restricted his consideration of liquidity preference to savings and investment. He sees the investor preferring the liquidity of cash and transferring funds from investments to savings in a depression. But an inflationary situation emphasizes the importance of a third alternative, namely goods. People tend then to prefer goods to inflated money and to decrease their demand for money in favor of immediate spending on goods as inflation hedges. In a depression the shift would be from investment to savings; during an inflation the shift would go into goods, resulting in greater total demand and even higher prices. Thus the Keynesian concept of the community's liquidity preference does not necessarily hold valid during inflation.

The classical economists had stressed the effect of a change in the amount of transactions money; Keynes emphasized the effect of a change in the amount of investment money on a depressed economy. The postwar situation thus sharpens the relevancy of classical interpretation.

Second, the Keynesian analysis makes no allowance for the anomaly of general prices remaining constant or even rising in the midst of a recession, that is, beyond those price increases which are due to "bottlenecks" associated with full employment. In other words, the institutionalized practice of administered pricing common in the American economy today is outside both the Keynesian theory of effective demand and the classical quantity theory of money. Inflexible prices "admin-

istered" by big business firms and big labor unions, irrespective of natural market forces, largely account for the anomalous phenomenon. This is where what Prof. Martin Bronfenbrenner terms "pressure economics" comes to the rescue. Collective bargaining, antimonopoly legislation and other institutions affecting the wage-profit relation would have to be investigated more carefully than most Kenyesian economists are prepared to do, or just as carefully as institutional economists insist on doing.

"Stock-conscious" country

Third, in a "stock-conscious" country like the U.S., the anti-inflation bias of financial institutions is much stronger than Keynes suspected. So powerful is that bias that the presumably impartial monetary and fiscal authorities seem unable to escape its influence completely, if one may judge from their greater readiness to adopt anti-inflation measures than to put antirecession measures into effect. Thus the Treasury has time and again yielded to the "dear money" policy of the Federal Reserve Board, even if a "cheap money" policy is what is needed for large and growing public borrowing. This occurred even when a "dear money" policy failed to restrain investments for most private capital goods and for public housing, investments which are called "interest-inelastic" because they are little affected by interest changes. At the same time the policy discouraged "interest-elastic" investments in private housing, public utilities and small business to a perhaps crippling degree.

Fourth, the income effect on saving-consumption patterns stressed by Keynes might have to be revised in an expanding, inflationary economy. If persistent inflation steadily decreases the purchasing power of money, the middle-class savers might perhaps lose their incentive to save. The majority of working families would probably go into dissaving via installment and other credit spending, if rising prices significantly reduced the purchasing power of current family incomes and if inflation intensified rather than diminished their desire to "keep up with the Joneses." Of the upper-income groups, the rentiers with fixed incomes might find themselves constrained to reduce their consumption, thereby giving rise to "forced saving" unwittingly. However, the price effect on saving-consumption habits is inconclusive, since extensive social security programs, the changing composition of the population, consumer credit systems, interdependent consumer preferences and many other habit-

changing variables may become operative in the long run. Again, the influence of institutional developments is much stronger than considered by Keynes.

Demand and capacity

It would be a mistake to assume, as some writers do, that persistent inflation is "inevitable" in a full-employment, expanding economy. One need not go all the way with Prof. A. H. Hansen in dismissing inflation as an unimportant secular problem for the American economy with its phenomenal capacity to produce. But one may plausibly argue that *if* the American economy succeeds in adjusting its rate of growth of *effective demand* to its rate of growth of *productive capacity,* secular growth without inflation is quite possible.

Hansen's famous thesis that the modern economy tended toward stagnation has been criticized as being apparently incongruous with the observed postwar prosperity of the American economy. Answering his critics, Prof. Hansen implied in his latest book, *The American Economy,* that the postwar American economy has grown and prospered almost continuously since the end of hostilities, not in spite of the stagnation thesis but because the thesis itself precautioned against undue complacence and overoptimism. It is true that Hansen almost singlehandedly made fiscal policy an accepted vehicle for stabilizing the American economy. It may be also true that the Hansen stagnation thesis was partly responsible for the governmental assumption of greater responsibility for countering fluctuations. It may deserve credit for the gradual provision of "built-in stabilizers" like progressive taxation, margin requirements, federal guarantees of bank deposits, social security plans, farm support programs, ready-made public works programs and minimum wage legislation. But then it would be rash to conclude that the American economy has become "stagnation-proof" *in fact,* or that we can accept a new doctrine of "secular exhilaration" without reservation.

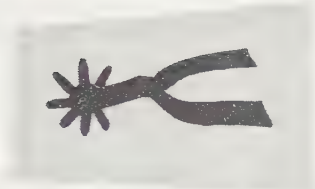
The postwar prosperity of the American economy may have been due to special circumstances, such as the "baby boom," the inordinate pent-up demand for consumer durables, the extraordinary need for fixed investment, and the reconstruction demand of war-devastated nations for our goods and services, let alone the effects of the Korean war and the cold war. Moreover, the recent growth discussions stemming from Keynes and Joseph Schumpeter strongly point to a persistent tendency to unstable growth in an advanced economy operating along the lines

mainly of laissez-faire. For these post-Keynesian growth discussions have shown that the productive capacity of an advanced economy tends to outrun its effective demand, or, alternatively, that the growth of capital tends to outstrip the growth of population. This would make the economy diverge downward from an ideal line of steady progress with full employment but without inflation or deflation.

Impersonal intermediary

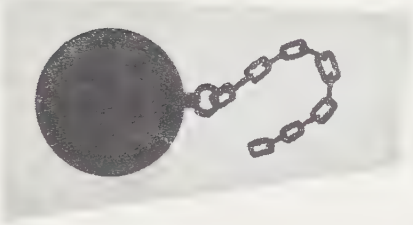
Postwar economists have been paying increasing regard to the growth of underdeveloped countries. Keynes himself powerfully helped to shift the center of gravity of professional attention to this long-run problem, despite his well-known impatience with the long run "in which we are all dead." For he had the foresight to blueprint the novel and far-reaching organization of a World Bank for Reconstruction and Development. To Keynes, the coprosperity and coviability of the world appeared to be essentially a technical question of making the saving propensities of its richer members compatible with the investment needs of its poorer members through an impersonal intermediary. Thus, he opened up the vast possibility of applying his saving-investment theory to the world economy as a whole. The World Bank was to be a revolutionary device whereby advanced economies might maintain *stable* growth by exporting their redundant capital without impairing the sensibilities of underdeveloped economies. These might attain *rapid* growth by importing needed capital without the traditional fear of foreign domination.

While admiring the remarkable achievements of the existing World Bank, one may nevertheless ask whether its present technique is capable of application on a "purely technical and nonpolitical" basis and "irrespective of the type and principle of government and economic policy existing in the prospective member states," as Keynes intended. For some important capital-rich nations still remain outside the World Bank to lend out arbitrarily, while some wealthy members tend to by-pass the bank by lending out unilaterally. The deplorable consequence is that the global narrowing of living-standard gaps is left to the accident of competitive power politics today, just as the international balance of payments was disastrously left to the chance of laissez-faire capital movements yesterday. In this respect, much more than in any other, the world has yet to learn from the spirit of Keynes as much as it learned from the wisdom of Adam Smith in the past. ■



Taxes in two perspectives

If they reduce the initiative of some people, taxes spur on others to intensified profit-seeking



by Walter W. Heller

■ OUR AFFLUENT SOCIETY has a much greater freedom of choice among various alternatives than most economies. This freedom can present agonizing problems. We are thus forced to make the choice between higher levels of social services purchased by taxes, and higher levels of private goods and services purchased in the market place. Our decision, moreover, is influenced by the fact that private goods and services involve but a single cost, while public services could imply a double cost.

The government is not necessarily done with the cost of a specific good or service when it has paid the market price. It must also calculate the possible loss deriving from the dampening effects of taxation on the citizen's will to work harder and earn more money. If these so-called disincentive effects are strong, then they should guide us in establishing our tax structure. Thus income taxes are considered to be in the high-disincentive class because they rise progressively with income. Sales and excise taxes (which do not) are placed in the low-disincentive class.

Individual and corporate income taxes account for 55 per cent of federal-state-local tax revenues, against 21 per cent from sales and excise taxes. We would have a strong argument for changing these proportions, if income taxes dampened initiative considerably. If, however, the disincentive effects are negligible, we can decide between public and private serv-

ices without having to make allowances for an extra cost element in the public sector.

Do taxes significantly reduce the amount of time worked, discourage entry into the labor force, cause people to shorten their lifetime working span, and redirect human effort from high into low efficiency channels? In short, do taxes curtail the effective supply of labor in all its forms?

Chain of assumptions

The indictment against the income tax as a deterrent to human effort arises out of two related facts: (1) the tax progressively reduces the net reward per unit for any given amount of work; and (2) the amount of tax the individual pays has no direct effect on the amount of service he gets from the government. In other words, the prosecution assumes that since the tax reduces the price of leisure in terms of effort, the taxpayer will choose to substitute leisure for some of the work he would have done in the absence of taxes. As a result of this "substitution effect," society will suffer a loss of production. But the defense counters with the "income effect": taxpayers are stimulated to work harder and longer to regain the income lost through taxation, thus increasing, not decreasing, production.

Suppose we accept for a moment the position taken by the prosecution and undertake to specify the individual links in the chain of assumptions that lead to the disincentive charge against the income tax.

- The first link is the assumption that income is our dominant goad to work. In our acquisitive, capitalistic society, income means material well-being–and to that extent net income after taxes is the spur to effort. But income is also sought as a badge of occupational success. For this function, income before taxes serves nearly as well as income after taxes. Quite apart from income, many taxpayers, especially in the professional and managerial groups, are striving for prestige, power, professional recognition and love of the game.
- The second link is the assumption that taxes vary directly with the reward for economic effort and hence reduce that reward. Here, the income tax is clearly guilty.
- Third, the taxpayer must be aware of the fact that the tax is whittling down the size of his reward for effort. In the case of the personal income tax, such awareness is probably accentuated by its withholding character, since it translates the tax immediately into smaller take-home pay. Sales and excise taxes, to the extent of "money illusion," have an advan-

tage over the income tax on this score.

• Fourth, taxpayers must have flexibility to vary their efforts in response to taxation. To the extent that they are bound by a conventional workweek or by commitments to partners in a firm or colleagues in a clinic, tax incentives, whether positive or negative, have little to work on. On the other hand, the assumed flexibility is present to the extent that workers have opportunities for overtime, absenteeism, "moonlighting," and longer or shorter vacations; to the extent that additional family members can enter or leave the labor force; to the extent that there are opportunities to change jobs or to postpone or hasten retirement; and to the extent that the taxpayer is self-employed and not bound by a rigid schedule.

• The fifth link leading to an adverse conclusion assumes that the negative effects of the income tax on the propensity to work outweigh the positive effects, that the "income effect"–the desire to work even harder to make up the tax loss–is more than offset by the "substitution effect." Not only is leisure substituted for work, especially in the high tax brackets, but even in fairly modest brackets there is considerable incentive to substitute untaxed "do-it-yourself" work for taxed work. We may term this the "diversion effect."

Consider for a moment this "diversion effect." All forms of work which do not bring their product to the market economy tend to escape the income tax. Whether it be the wife's household services or the husband's gardening or plumbing, the income tax stimulates the flow of labor into these pursuits in preference to taxable pursuits in which the individual may be far more productive. For example, if a taxpayer is subject to a 30-per-cent marginal rate of tax, he will be at least as well off financially to rewire his house at a saving of 70 dollars as he would be if he spent the same time earning 100 dollars on his job. If he substituted loafing for work, society would lose 100 dollars worth of output. But here it still loses 30 dollars, because he is substituting inferior for superior uses of his time, economically speaking.

Power and prestige

But we do not have to rely entirely on guesswork to test certain links in the chain. A study made at Harvard by Thomas H. Sanders strongly suggests that in the case of the executive, managerial and entrepreneurial groups who are subject to the highest surtax rates, the profit motive is typically subordinated to the quest for

power and prestige. Sanders concludes that "for the most part, with considerable exceptions, businessmen are currently working as hard under high tax rates as they did under low tax rates. . . ."

In working with corporate executives earlier this year, I posed the question: "To what extent and in what way, as a practical matter, do federal income taxes enter into executive decisions to work harder or to slow up?" Three of the four groups concluded that nonmonetary motivations played so strong a role in their total incentive picture that taxes had little or no effect. The fourth group concluded that while the opportunities for top corporate management to reduce work hours were most limited, taxes might still have a considerable effect in quelling the initiative of younger men entering industry, and, particularly, of self-employed business and professional people.

What evidence do we have on the direction and intensity of the work response of nonexecutives to the income tax? For the great mass of workers, the fixed workweek limits the opportunities for withdrawing labor from the market in response to taxation. But conversely, considerable opportunity exists for increasing work efforts by taking second jobs to make up tax losses. If workers reject opportunities for more work, then they are reacting to the disincentive feature of taxes.

But what of the most sensitive group, the self-employed professional and business group? I can offer at least a thimbleful of personal survey evidence. At the outset of an address to 78 members of a League of Woman Voters in Minnesota, I put the following limited question: "As a result of the higher levels of income taxes now in effect (1951), does your husband work more, less, or the same as he did when income taxes were lower?" Fifty replied "the same," and 28 replied "more." Not one replied "less."

Chilly tax climate

Far overshadowing this modest probe into tax responses is the searching and skillfully executed survey by Professor George F. Break of the University of California. Break selected the most tax-sensitive sample group and the chilliest tax climate he could find: solicitors and accountants in Great Britain whose practices bring them in continuous contact with tax problems and whose marginal tax rates are far above those in the U.S. In the 5,000 to 10,000-dollar bracket, their rates range from 33.5 to 60 per cent against our 20 to 22 per cent. On the basis of 306 interviews, Break concluded: "We find nearly 20 per cent reporting an impairment of incentives due

to taxation and over 30 per cent evidencing the opposite effect." The net effect, disincentive or incentive, he reported as "not large enough to be of great economic or sociological significance."

Break's research findings are indeed remarkable in the face of (1) income tax rates that are frequently described as severe or even "savage," and (2) considerable flexibility in work schedules and great awareness of taxes on the part of the interviewees. His analysis indicates that nonmonetary motivation and, particularly, the pressure of heavy savings commitments in the form of mortgages and insurance programs limit the incentive effect of taxation largely to the emotional realm: "There is no escaping the fact that, thus far at least, disincentives, like the weather, are much talked about, but relatively few people do anything about them."

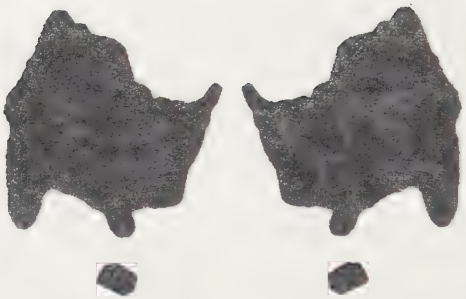
Effects and desires

Break concludes: "From the present evidence, then, we must conclude that contrary to the frequently repeated injunctions of so many financial commentators, solicitude for the state of work incentives does not under current conditions justify significant reductions in the role of progressive income taxation. Indeed, it would appear that, in the United States at least, income tax rates could be raised considerably, especially in the middle and upper-middle income ranges, without lowering unduly the aggregate supply of labor."

These conclusions do not necessarily apply to investment incentives. The adverse effects of taxation are not countered here by desires for personal status nor are they hampered by restrictions as to flexibility or action. Evidence developed by the Harvard studies shows that the effect is mainly on the *direction* of investment rather than on the aggregate of risk-taking activity.

However, let me add also a few words on labor productivity. To the extent that the proceeds of higher levels of taxation–with their greater disincentive potential–are utilized to raise standards of education and vocational training, health, nutrition and housing, they may enhance labor productivity more than would alternative uses of the funds. This would be a further offset to adverse incentive effects and might, indeed, lead to net expansionary effect on total output.

Insofar as the impact of taxes on incentives is concerned, the contest among the various claimants of shares of our new abundance can proceed without prejudice to the claims of government. ■



MORALE IN OUR SOCIETY

How people feel and think is an important factor in the operations of our political economy

by Joost A. M. Meerloo

■ WHEN Orson Welles made his realistic radio broadcast on an "invasion from Mars" in 1938, he could hardly have expected to find so much hidden anxiety among his listeners that his narrative would create a real panic. This incident already shows us the core of the problem of morale. While the outer emotional aspects of a society can look quiet and stable, hidden underground rumblings may be going on that are not easy to gauge. Is it possible to determine whether a social formation has a strong inner cohesion or is close to a breakdown? Decay and downfall are inherent factors in any social system, whatever inner strength this system may have had before.

What is the meaning of that strange word, "morale"? The term is used to indicate the inner strength of an individual as well as the cohesive strength of social groups. The concept of morale is bound to the survival expectation of man and society under stress. The dictionary defines morale as "a state of mind" determined by a totality of binding psychic factors such as zeal, spirit, courage, hope, confidence and *amor fati.* More explicitly, we can explain morale as man's fortitude and tolerance-capacity. People's morale may be high in the most difficult and dangerous situation and low in times of apparent peace and quiet. Good morale indicates man's ability to meet challenge and frustration, and his capacity and preparedness to sacrifice for a com-

mon aim. Psychologists name this quality "ego strength," a state of unfrustrated alertness. The high morale of the social formation is expressed in solidarity, endurance and emotional equanimity.

An exact definition of the concept of morale is not terribly important. As in many clinical descriptions, it is better to approach our subject in a negative way by asking: "What are the factors that depress morale?" and "Where are the negative points and influences that make us conclude that a person's or a group's morale is low?"

Panic and courage

A basic question must be answered before describing some of the well-known characteristics that help to establish the diagnosis of a vulnerable morale. Is there a relation between individual mental weakness and collective breakdown? There is indeed. Everyone contributes to the mental health of his community. One hysterical person can with his anxieties infect a mob and start a panic. In our age of mechanization, with its intensified means of communication, both panic and courage can be transferred more easily than before. The cold war exposes people continually to synthetic mass suggestions. The self-confidence of a leader or a government–with whom the masses unwittingly identify themselves–plays an important role in national courage. Churchill's courage and spirit during the Battle of Britain constituted an important part of British fortitude.

No clinician has as yet been able to state the positive health of a person or a group because it is impossible to probe and reckon with the unconscious currents of unreality and fanaticism. Following are some negative points indicative of low morale:

• *Lack of discipline.* An inherent relationship exists between morale and discipline. It is the initial molding of socially acceptable qualities in the child that will give him self-confidence. The fear and reluctance of many parents to discipline their children tend to lessen the appreciation of the young for their heritage of the principal liberties and the will to protect them.

• *Obvious or inadvertent addiction.* The fact that alcoholism has become such a harrassing social problem indicates an existing need to escape reality through a form of slow suicide. The weak need a crutch to reach a state of gaiety and relaxation; strong people can be exuberant without alcohol. The same danger lies in inadvertent addiction to tranquilizing tablets. A tendency to addiction to tranquilizers and other medical fads suggests a poorly concealed anxiety and the insecurity of a coun-

try in the midst of growth pangs. The cult of material dissatisfaction, to which people are daily exposed through seductive advertising, coerces them to buy more and more unneeded gadgets without satisfying their feelings of deprivation.

• *Increasing youth criminality.* This social disorder indicates not only a diminishing impact of the paternal authority, but also reveals the hidden fears of young people living in a world of growing pressures. Their unchecked hostility usually takes the form of boastful pranks to cover up feelings of despair and inferiority.

• *Diminishing interest in the Commonweal.* A short while ago one of our television stations interrupted a Western film to give time to our President when he spoke for the UN on threatening international occurrences. The next day the station was flooded with vehement protests about the interruption in the people's soothing leisure time. There exists a tremendous need to deny real dangers, as we see, for instance, in the indifference toward problems of Civil Defense. The short-term policy of sensational pleasure, disguised behind a facade of complacency and stoicism, can become more important than a serious planning for the future.

• *Self-brainwashing–inadvertent identification with the enemy.* One of man's most dangerously passive attitudes toward stress and challenge is his mental surrender before the battle is fought. Such inadvertent self-betrayal–through the fear of facing danger –is easily proved in individual neuroses.

A good scale

I remember in the days of the late Senator Joseph McCarthy's greatest influence that many students refused to express private opinions during an academic discussion. How much fear there is of the few bullying voices and terrorizing minorities represents a good scale with which to measure the morale of a country.

The fact that during the Korean conflict nearly 70 per cent of the prisoners of war cooperated with the enemy in some way–to an extent not permitted by military instructions–cannot be explained solely as indicating a simple lack of morale. Under extreme physical and mental terror nearly everybody can be forced into a breakdown. The soldiers lived isolated from any inspiring leadership and were, moreover, completely unfamiliar with the enemy's tactics and aims. It is remarkable that so many were able to stand their ordeal.

The importance of mentioning negative factors is that awareness of their presence enables us to

eliminate many of the dangers they provoke. Searching out these negative factors, however, does not mean that there is no other side to the coin. Factors of positive morale can be listed:

• *The love for the American experiment.* Although the cliché "the American way of life" has an ambiguous meaning, it is mostly used to indicate the occurrence of something that is different from any other experience. America started the great pioneering adventure of a new Declaration of Rights for a melting pot of many races and people. It is a very young social experiment in mutual tolerance. The open legal battle for racial integration is part of this pioneering effort of which the people are proud, even though many are against certain aspects of it. However much they may temporarily dread the movement toward equality of the races, they still love the progress of justice benefiting each individual.

• *The resistance to collective suggestion.* During election days one happily learns how independently the voter usually votes, undisturbed by the barrage of suggestive headlines. Free public opinion has often expressed itself against the opinion-engineering of the greater majority of the press.

• *The option for personal freedom.* The freedom to agree or to disagree belongs to the pioneering spirit that is revived each time a coercive attack is made on freedom of thought. Although there is a movement toward conformity, people do not want to be in awe too long of an institution or a person. Even the President is occasionally slapped on the back to indicate that he is one of us, although temporarily chosen number one. The American slap on the back is the token declaration of independence in which everybody identifies himself with the greatness and mission of his country. Maybe it betrays an overoptimistic attitude, because the adventurous expansion towards an open frontier is no longer possible and people must learn to settle down.

• *The freedom of religion and creativity.* Early in colonial history American puritanism symbolized a search for responsibility amidst a variety of values. The positive aspect of our present booming church attendance is more than an indication of the need for religious awareness. It expresses the desire for social belonging in dedication to a common moral goal. The existence of manifold religious currents bears witness to the eagerness and depth of such a search for values.

Burst of creativity

All over the country a tremendous burst of artistic and philosophic creativity is taking place–

sometimes, alas, hidden behind the mercenary veil of Hollywood–but this will gradually give better shape to the aims and deeper values of our commonwealth.

Experiences with man's behavior under adverse circumstances, in POW and concentration camps, prove that there were particular inspiring ideas which made even the seemingly unbearable tolerable. Man must have faith, simple faith in religions and ethical values, faith in humanity and confidence in his own goals. There must also be the inner awareness of acceptance in spite of temporary disaster; the knowledge that somewhere on earth a friend or a beloved is waiting for him keeps man's hope and faith alive.

An idea illuminated by faith regenerates the spirit and vibrancy of the group. Faith in one's mission, faith in political ideology and religious faith have in the past kept people together under extreme stress. At the moment of challenge the guiding idea became so important that it could carry along the frail body.

It is difficult to measure the total morale of the American people, but clinicians can detect a latent fear that expresses itself in anxious excitement about unimportant occurrences. This fear doubtless reflects the negative morale factors I listed earlier. Its paradoxical effect is to turn people into passive escapists. The absence of a feeling of involvement in the Quemoy incident and an ignoring of the possibilities of nuclear war reveal a hollowness in national morale.

Our world is full of artificial means which blind people so that they forget their responsibilities. As long as a stress situation is part of an anxiety-provoking sensation, people will be unable and unwilling to face what must be faced. The individual must draw on his private quality of emotional strength built up by faith in his goals. The group must become an effective social formation hearkening to vigorous leaders and rejecting contagion from the weak. When danger becomes an accepted challenge, man can start mobilizing and strengthening his inner forces. ■

Answers to Challenge Quiz

(see page 79)

(1) False *(see page 62)*
(2) True *(see page 53)*
(3) True *(see page 13)*
(4) False *(see page 31)*
(5) False *(see page 67)*
(6) True *(see page 8)*
(7) True *(see page 71)*
(8) False *(see page 37)*
(9) False *(see page 19)*
(10) False *(see page 24)*
(11) True *(see page 48)*
(12) False *(see page 29)*

Challenge Profile

Adriano Olivetti— International Manager

■ HISTORIAN Sir Arnold Toynbee has celebrated the values of exile in developing the powers of the leader. The career of Adriano Olivetti, 57, who himself likes to look to great leaders for guidance, is a nice illustration of Toynbee's thesis. If Olivetti had previously demonstrated great capacities, exile enabled him to give them dimensions well beyond those of a merely successful manager.

The United States knows the Italian executive chiefly through his graceful portable typewriter, which has vigorously invaded the home market. His firm is the largest European manufacturer of business machines, with more than 20,000 employees, factories in five and distribution in 106 countries. If the esthetic element, important in the Olivetti operation, has attracted the customer's eye, the dependable efficiency of Olivetti machines has kept his allegiance after the first sale.

Olivetti looks esthetic rather than efficient, confronting the world with gentle eyes set deep in a broad, white-fringed skull. A shy man, he achieves communication with others through warmth and cultivated intelligence.

Olivetti owes an important part of his executive philosophy to this country, where he visited 100 plants and studied management theory in 1925. He began work by continuing his reading in the factory founded by his father in northern Italy. During the last years of his father's life–Camillo Olivetti died in 1932–the plant was changing from artisan to true manufacturing character. The younger Olivetti, cherishing the pleasant working relations under the benevolent founder, concen-

With each issue CHALLENGE profiles a person whose thinking affects the pace of the United States economy.

trated on institutionalizing that warmth as expansion and mass-production methods made personal contact more difficult. He still keeps his office door ajar for the worker with a personal problem, while the major social burden is borne by housing and health services, nursery schools, recreational facilities and a pay scale 30 per cent above the Italian minimum.

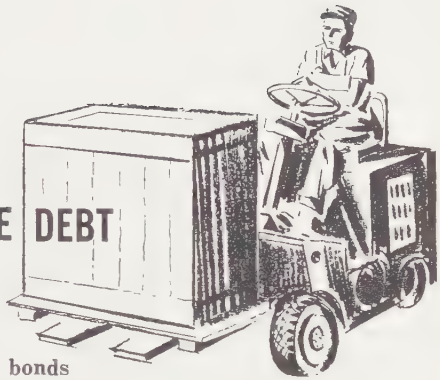
Arrested in 1944 as an anti-Nazi, Olivetti escaped from a Roman prison and slipped into Switzerland, where he had time to ponder the connection between the war holocaust and his own work. He has since drawn strength, while resisting confusion, from such varied sources as Ghandi, Einstein, Schweitzer, Tolstoy and Kierkegaard.

Returning in a mood of inspired efficiency to Olivetti headquarters in Ivrea near Turin, he led the organization to new humanistic heights that have not prevented the regular emission of a five-percent dividend. But the factory was not enough and Olivetti founded the Communita movement in 1948 as an action to revive the strength of local communities. The movement develops new industries and encourages prideful self-government, a worthy objective that Olivetti's imagination has nevertheless overshot.

Distrusting parties and parliaments, Olivetti would have Communita prove that the state can exist without them. Unashamed of the banal, he appeals to "truth, justice, beauty and above all, love" to help men manage the great material forces. He would like to see the nation as a complex of communities inhabited by completely humanized, intensely participating citizens.

Despite the Olivetti antipathy to wordly politics, Communita ran 100 candidates in the recent parliamentary elections. Olivetti was the only winner. His leadership in local issues has, moreover, produced another contradiction, albeit a pleasant one. The prosperity assisted by the modern management that Olivetti typifies has given the national government a new strength, and Prime Minister Amintore Fanfani, developing his program first as Public Works Minister, has been able to make reform a reality in the backward south, and in agriculture and unemployment policy.

It is improbable that Olivetti will be able to transfer his force directly to the national scene. The Christian Democrat Fanfani can depend on a more conventional spirituality in carrying out a program that includes more political expediency than Olivetti would accept. The Olivetti ethos is, however, a growth situation with potentials that far exceed today's dividends.–D.F.



MANEUVERING OUR MASSIVE DEBT

We expect the Treasury to fight inflation, but we also require it to sell inflation-abetting bonds

by Benjamin Caplan

■ THE U.S. TREASURY is doubly afflicted these days by the contradictory responsibilities of monetary policy and debt management. It is faced with the largest peacetime cash deficit on record, an estimated 13.7 billion dollars for the present fiscal year. In addition, it must refinance approximately 67.8 billions of old debt maturing during the current fiscal 1959 and thus due by the end of June, 1959. A third of the 67.8 billions is composed of 91-day bills which must be "rolled over" or refinanced every three months.

Holders of savings bonds, furthermore, may seek to cash them in at a faster rate than they are sold, a fact that would add to the Treasury's requirements for new money. It must carry out this gigantic financial task at a time when the government bond market has been badly shaken by the collapse of last July.

Of crucial importance to the Treasury's endeavor is the policy of the Federal Reserve Board, acting as a legally independent agency. The FRB can control the supply of money by purchases and sales of government securities, changes in reserve requirements and by rediscount policy. An easy money policy with consequent low interest rates facilitates borrowing of all kinds, including the Treasury's, and acts as a stimulus to the economy; a tight money policy acts in reverse. Thus the problem of debt management is indissolubly linked to that of monetary policy, and both in turn have widespread effects on the health of the economy.

The sequence of events which led to the collapse of the bond

market illustrates clearly the relationship between debt management and monetary policy. In August, 1957, the rediscount rate was raised to 3.5 per cent, the highest rate since 1933. As a result of the developing recession, the Federal Reserve in November, 1957, switched from a tight to an easy money policy as an antirecession measure. It lowered the rediscount rate, by stages, to 1.75 per cent in April, 1958, reduced reserve requirements for member banks and engaged in a policy of buying government securities to expand further the excess reserves of banks.

The result was a boom in the bond market. A bond boom raises bond prices, decreasing the ratio between the fixed interest income and the purchase price of the bond; thus the "yield" to the purchaser is reduced. Yields on long-term governments, which had reached a postwar high of 3.77 per cent in August, 1957, fell to a low of 3.12 per cent in April, 1958. The Treasury, taking advantage of the increased demand, was able to float considerable amounts of intermediate and long-term bonds.

Final phase

The final phase of this easy money period occurred in June. The Treasury successfully raised 1.1 billion dollars of new money by floating a 3.25 per cent bond due in 1985. In addition it successfully refinanced about 9.5 billions of maturing debt with a 2-5/8 per cent bond maturing in 1965. The bond market, influenced by the progress of the easy money policy, counted on continuation of the easy money policy. It therefore regarded these issues, particularly the 2-5/8 bond, as certain to go to a substantial premium, and a tremendous amount of speculative buying took place.

The economic situation had begun to improve in the spring of 1958, and the stock market began to rise. Late in June, rumors began to be heard that the Federal Reserve, concerned about the resurgence of inflation, was considering a switch back to a tight money policy. The bond market broke and speculators ran for cover. Yields on long-term government bonds rose from 3.14 per cent in May to 3.36 per cent in July as prices fell. In July the Treasury took the unusual step of buying almost 600 millions of the 2-5/8's to support the market. Furthermore, the Federal Reserve, which normally buys only short-term government securities, took the emergency step of buying longer-term government securities. Although these measures had a temporary rallying effect, the serious decline in bond prices was subsequently resumed.

In August the Federal Reserve raised the rediscount rate from 1.75 per cent to two per cent and took measures to reduce the excess reserves of the banks to make money more difficult to obtain. Thus the period of easy money lasted at most 10 months and was effectively over in seven months. This is perhaps the quickest turnabout in FRB history. It was influenced by what the Federal Reserve regarded as its mistake during the 1954-57 boom, when it moved, as it thought, too slowly to tighten credit and when the cost of living rose more than eight per cent from 1955 to 1957.

Act of patriotism

Treasury Secretary Robert Anderson has urged insurance companies, savings banks and other financial institutions which receive a flow of long-term funds from the public to invest in government bonds as an act of patriotism. These institutions have been reducing their holdings of government bonds substantially because of the more profitable opportunities for investment elsewhere.

The Treasury is concerned with the large proportion of short-term issues in the debt structure, a problem which has been growing through the postwar period. Between mid-1946 and mid-1958, the gross debt of the United States increased slightly, from about 270 to 276 billion dollars. During the same period, the marketable debt, securities which can be bought and sold in the market, declined from about 190 to 167 billions. (The nonmarketable debt, consisting of special issues for the trust funds such as the ones for social security, increased as a whole.) On the other hand, the short-term marketable debt consisting of issues maturing within five years increased from 97 to 109 billion dollars. Thus the short-term issues constituted about half of the marketable debt in 1946; today, they form almost two-thirds of the total.

An undue proportion of such short-term issues means almost constant visits to the money markets and the hazards due to sudden changes in monetary conditions. It deprives the Treasury of the chance, open to other borrowers, to pick the most favorable modes and opportunities for borrowing. Moreover, short-term issues tend to be largely held by commercial banks. Borrowing from banks tends to be inflationary, since any new money borrowed from banks means creating bank deposits, and thus can cause increases in the monetary supply. Borrowing from nonbank investors, on the other hand, means a shift in money from the lenders to the borrowers with no net addition

to the monetary supply. Furthermore, banks with large holdings of government securities can borrow money against them from the Federal Reserve, thus further adding to the monetary supply. Both the Treasury and the FRB have therefore been anxious to see more of the debt held in nonbank hands and on longer maturities.

The Treasury has, within the last year, been lengthening the average maturity of the debt. Between mid-1957 and mid-1958 it added over eight billions to the five-to-ten-year group. over four billions to the 10-year group, and even reduced the under-five-year term by a few billion dollars. By this policy, the Treasury is entering into competition with other borrowers of long-term funds: builders, corporations carrying out investment programs, and state and local governments.

Proceed with caution

If the demand for long-term funds is large, the effect of the added Treasury demand would be to raise the interest rate and thereby to discourage private investment. The Treasury must therefore tread warily in its policy of long-term issues. On the other hand, the FRB is concerned that if it supports the bond market in order to aid the Treasury, it will expand the monetary supply unduly and stimulate inflationary pressures. Certainly, the recent gyrations in the bond market do not augur well for the success of any substantial long-term issue of government bonds in the near future.

With the government bond market unpropitious under present conditions, the Treasury must rely heavily on short-term financing. This disturbs the Federal Reserve because it means greater use of the banks. Since it is unthinkable that the FRB will fail to make funds available to the banks to permit them to buy the government short-term issues, this would limit any tight money policy the Federal Reserve seeks to carry out.

The current clash between debt management and monetary policy arises out of the extremely rapid reversal of the 1957-58 recession. Indeed, there is a paradox in this situation. Fundamentally, tax policy is one of the most powerful instruments the government possesses for countercyclical action, because taxes directly affect the flow of purchasing power. Monetary policy, on the other hand, can only operate on the credit environment affecting decisions to produce and invest. Indeed, our government structure is so geared that the budget is virtually compelled to incur a deficit when a recession develops. Moreover, financing a deficit by short-term borrowing

from the banks is itself a counter-recessionary device, since borrowing from the banks creates money and thus adds to the monetary supply. Similarly, in periods of prosperity the budget tends to operate with a surplus, which permits repayment of debt or the freezing of purchasing power. Longer-term refinancing by the government in periods of prosperity can aid in offsetting inflationary pressures, since the government would be borrowing from investors who might otherwise go into private investment.

The way out?

The difficulty the government faces is that it is running this tremendous recession-inspired deficit just when the FRB considers that the situation has changed from being actively recessionary to potentially inflationary. The success of the deficit in offsetting the recession is the cause of the Treasury's difficulty with debt management.

The current clash between the Treasury's need and the FRB's policy is not new in the postwar period. In March, 1951 the Federal Reserve was freed from following the wartime policy of supporting the government bond market. The famous accord multiplied the difficulties for the Treasury.

What, if any, is the way out of this dilemma? The issue is the role which monetary policy should play in furthering the national goal of stability and growth under conditions of full employment. Our postwar national economic policies have not eliminated the business cycle; we have had three recessions in the postwar period. Our policies have been most successful in preventing deep depression and, in fact, have kept the recessions within very narrow bounds. However, inflationary pressures have been intermittent and the cost of living rose eight per cent between 1955 and 1957. It may well be that we cannot maintain growth without some sacrifice of stability or, alternatively, that we must sacrifice some growth for stability.

How can monetary policy offset price increases? It depends on the causes of the price increases. It would be hard to find the major cause of price rises in an excess of money. Indeed, the monetary supply rose less than two per cent per year between mid-1953 and mid-1957. This is a rate less than that consistent with stable prices in an economy growing at a rate close to four per cent per year. To meet the economy's need for more money to finance the growth in output, there was a large increase in the velocity of money, the rate at which money is turned over. Rather, most price increases result from specific supply-demand

situations in goods and services, and from the attitudes and powers of government, businessmen and unions with respect to price and wage policies.

It is conceivable that a sufficiently tight monetary policy can prevent any general price rises, but it probably could only be achieved with substantial unemployment. The managers of monetary policy make only modest claims for what can be achieved. William Martin, FRB Chairman, has recently said: "In cyclical process, monetary management has a responsibility to use such powers as it possesses over economic events to dampen increases in economic activity." Thus, at most, the claim is not that money management would eliminate increases, but only that it could dampen them.

There is always the danger that monetary policy may produce a recession by making money too expensive. It may be more than a coincidence that the tight money policy of the Federal Reserve entered its most active phase just before the recessions of 1953-54 and 1957-58.

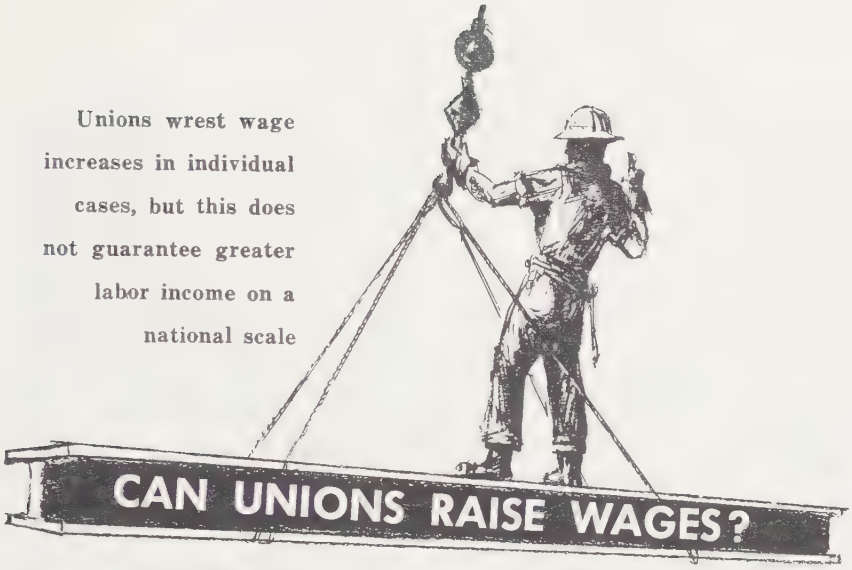
Our national policy of full employment and growth makes both good economics and good politics. If, as the result of such a policy, serious inflationary pressures tend to occur, it is unreasonable to throw the whole burden of stabilization upon monetary policy. Alternative methods need to be developed. The problem requires controls which operate directly on the sources of inflationary pressures. The monetary authorities have already recognized the need for such additional direct controls in their request for standby consumer credit controls to repress demand when it threatens to become excessive. The government, through its variation of the terms of purchase for houses bought under the FHA and VA programs, possesses powerful devices for controlling the rate of residential construction.

It may be possible to develop similar controls over business investment and inventory purchases. Finally, it may be necessary to develop national policies to deal directly with the problem of the wage-price spiral. With greater emphasis on alternative methods of stabilization, a better coordination between debt management and monetary policy can be achieved. ■

Health and Wealth

THE AVERAGE PERSON today sees his doctor about five times a year, almost twice as often as did his counterpart 30 years ago, when high-income families averaged half again as many visits as those with the lowest incomes. Today, the influence of income is negligible.

Unions wrest wage increases in individual cases, but this does not guarantee greater labor income on a national scale



CAN UNIONS RAISE WAGES?

by M. W. Reder

■ DESPITE the bitter disagreement over the virtues of labor unions, men of affairs rarely ask whether these organizations really succeed in their objective of raising wages. The dispute usually turns on the alleged consequences of success such as inflation. Professional economists, however, do not agree what the real effect of unions on wages is.

When they doubt that unions raise wages, economists seem to be defying the judgment of experienced men on both sides of the bargaining table. To the man in the street, it seems obvious that the strike threats, offers and counteroffers mean a struggle in which unions are trying to push wages up and employers to keep them down. How can the manifest facts of a struggle between unions and employers be reconciled with the view that "unions don't have much effect on wages"?

No competent economist would deny that sudden surrender by a union in the midst of a strike would, at least for a time, set wages somewhat lower than they would have been if the union had fought to the end. But the very existence of collective bargaining often leads employers to make initial wage offers that are less than what they expect the union to accept. They plan to improve these offers under the pressure of union bargaining, but only after a show of resistance. The union negotiators must appear to have wrested gains from reluctant employers. If the union seems to

have obtained no more than what the employer would willingly have conceded, the members will soon demand that the union "use its muscle." Public statements often exaggerate the extent of the disagreement between unions and employers.

It must be remembered that collective bargaining involves–as the name implies–a bargain between two parties. The union cannot impose terms unilaterally; the employer must be induced to accept them rather than to close down. If the union's terms are too onerous, the employer will close down temporarily, or even permanently. Unemployed workers pay no union dues and are very anxious to get back to work. Employers, on the other hand, are more anxious to continue producing when demand for their output is strong than otherwise. Unions can obtain better terms from prosperous industries, while they make milder demands if an employer is in competitive difficulties. Thus the "ability to pay" factor is a very important determinant of the wage increase a union can negotiate.

Indirect effects

This is not to deny that many an employer has been "caught in a wage pattern" and forced under strike threat to pay more than he expected or thought he should pay. However, it is necessary to consider the indirect effects of such wage hikes. If an employer is compelled to raise wages, he may become able to attract a better type of labor than before. This may increase the demand–and wages–for these superior workers, but lower the wages or cause unemployment among previously employed workers. Union wage pressure in one geographical area may ultimately drive plants to other areas, reducing labor demand and possibly reversing the initial wage increase.

The indirect and delayed effects of a wage boost *may* thus partially or wholly offset the more direct and immediate ones. But there is no guarantee that this *will* happen. Economists have debated the effect of unions on wages; they disagree on its magnitude and even on its direction. This debate has centered around two questions: Have unions raised the wages of their members relative to those of nonunion workers; and have union wage demands been an important inflationary force since World War II?

If unions do force wage increases, it would seem that the wages of unionized workers should be higher than those of *comparable* nonunion workers. Union workers do get higher wages in general, but this is often due to other factors. Unionists are predominantly in large cities where

wages are relatively high; they are disproportionately concentrated outside the low-wage South and are infrequently found in low-wage industries such as retail trade and agriculture. It is possible that these predominantly nonunion areas and industries are low-wage precisely because they have not been unionized, but this cannot be proved and some deny it.

Limited results

It is necessary to compare the wages of groups of union and nonunion workers who are similar in all the characteristics that might cause a wage advantage to one group or the other. This is what is meant by studying the wages of groups of *comparable* workers. Limited results have thus far emerged from these studies of such groups. Among workers who are paid on a time basis, union workers usually earn more than nonunion in the same region, industry and occupation. The differences, however, are not large–about five per cent. Moreover, the difference in wages among workers in different regions without reference to union membership is appreciably greater than that between union and nonunion workers. Furthermore, among workers paid on an incentive basis, nonunionists sometimes earn more than union members. On balance, however, union workers do seem to have a slight advantage.

The interpretation to be placed on this fact, however, is far from clear. Some economists contend that the wage gains wrung from employers by union pressure are then extended, wholly or in part, to nonunion workers solely because their employers wish to avoid unionization. But other economists believe that the wages of nonunion workers would rise because of the forces of supply and demand, irrespective of employers' fears of unionization.

Studies have also been made of the wage gains in unionized and nonunionized industries. They fail to show any consistent advantage for the unionized industries; indeed, in some time periods, the wage increases tended to be greater in industries that were largely nonunion. One reason is that the government has given a great deal of special assistance to the predominantly nonunion low-wage earners by means of minimum wage legislation and exemption from the World War II wage freeze. The maintenance of substantially full employment since 1941 has had an especially beneficial effect upon the wages of unorganized unskilled workers.

One very important practical question concerns the effect of unionism on the level of all wages. Has the increase in wages since

the mid-1930s been primarily the result of unionism, or would other forces have brought it about in any case?

Any sensible discussion of the general wage level must begin by recognizing the fact that there has been a rate of increase in man-hour productivity of about two per cent per year. This increase has been the combined effect of technical progress, capital accumulation and improved education. It began long before unionism was a significant phenomenon in the United States.

Wage-price spiral

Increases in *real* hourly wages must come either from increases in productivity per man-hour, or from a reduction in the nonlabor share of output. The evidence indicates that if there has been a secular increase in the share of wages in national income, it has been very small–after due allowance is made for shifts of workers from self-employment to wage earning. This means that most of the gains in *real* hourly earnings have "come from" increases in man-hour productivity. It also means that the increase in *money* hourly earnings which since 1940 have been about one and a half times as great as those in real terms, must have been associated with increases in product prices.

This leads to a much discussed question: To what extent have union wage demands been responsible for increases in consumer prices–for inflation? Union spokesmen insist that the problem of the "wage-price spiral" is primarily one of curbing the greed of corporate business and agriculture. Business spokesmen reply that the greater part of postwar product price increases have been necessary to prevent increases in wage and material costs from cutting into profits.

To a considerable extent, the dispute disappears as soon as it is recognized that a sizable part of the increases in living costs stem from rising food prices. But there is also a genuine issue between unions and business concerning the distribution of the sales dollar between profits and wages. The issue is much too involved for a brief discussion. However, it may be said that no practicable reduction in profits would make a *major* contribution to reconciling rising money wages and a stable price level.

The relation between the levels of wages and prices inevitably involves a third variable, the stock of money. Most economists would agree that it is the relation of this last variable to the rate of physical output that is the primary determinant of the general price level. There is no dispute that stock of money imposes an

upper limit to the price level. Since World War II, the monetary authorities must have pursued a "permissive policy," permitting the quantity of money to expand sufficiently to support higher price levels.

When a union and an employer negotiate an agreement, the wages and resulting product prices are determined without direct reference to the over-all price level and volume of employment. The combined effect of such bargains could lead employers to raise the general price level. But if the monetary authorities steadfastly refuse to increase the stock of money, it will be impossible to sell the current level of physical output at an increased level of prices. Consequently, inventories of goods will begin to pile up and prices will have to fall in order to encourage sales.

Surplus goods

An undesired accumulation of goods leads not only to declines in prices, but also to reductions in output and employment. When the resulting unemployment appears, great pressure is placed upon the monetary authorities and other agencies of the government to "do something" to end it forthwith. This means increasing the money supply. Indeed, the pressure for a full-employment policy has been stronger than the pressure for stable prices. The effect has been secular inflation.

It is frequently alleged that the difficulty of reconciling full employment and a constant price level is due mainly to the wage demands of labor unions. However, it is debatable that wage demands have been the major cause since 1945. In 1950 and 1951, the Swedish unions agreed to refrain from asking for improvements in union contracts. Within two years there was a noticeable upward drift of wages as employers competed for scarce labor. Similar forces have probably been at work in Great Britain and the U.S.

The influence of unions upon wages often tends to be exaggerated, but this is not to argue that unions have no effect upon wages. Unions have tended to reduce the arbitrary wage differentials that once were found among persons doing the same job in the same city, and sometimes even in the same firm. In some localities, unions of skilled workers have set wages well above the levels of a competitive labor market. Moreover, some unions have used their bargaining strength to curb the use of labor-saving devices. I would not rule out the possibility that unions have increased labor's share of the national income and altered the occupational wage structures, but the evidence is far from compelling. ■

M. L. Frankel

Director, Joint Council on Economic Education

The Uses of Economic Literacy

Q *Dr. Frankel, as Director of the Joint Council on Economic Education, you are in an ideal spot to answer this question: How literate, economically speaking, is the average American?*

A I would say that there is no question about the fact that the average American is far more knowledgeable about his economic system than the average citizen of almost any other country in the rest of the world.

Q *Well, if that is so, why do we need organizations such as yours which strive to improve the quality of economics instruction in the schools and, therefore, the long-run economic literacy of the population at large?*

A I think the basic answer to that question lies in the American system and in the ways in which changes are brought about in that system. If we were living in a country where decisions were made for us, then it would be a very simple thing to get a small group of highly trained people and have these people tell us what we are supposed to do. But our country depends on decision-making by all the citizens. And these decisions will only be as good as the composite individual decisions of the community. Therefore, the more that we can do to make individual decisions more intelligent, the better will be the policies–individual and public–upon which our standards of living ultimately depend. Since, in this day and age, many of these decisions require a knowledge of

economics, the economic literacy of our citizens clearly becomes a matter of primary importance.

Q *What is the Joint Council's contribution to this economic education?*

A The Joint Council is a private organization, financed by a number of private foundations, including the Ford Foundation, the Committee for Economic Development and the Sloan Foundation, which assists schools and teachers in their efforts to develop a greater understanding of the American economy. What distinguishes our efforts from those of other organizations is our emphasis upon the teacher. Rather than producing economic materials for student use in the classroom, we are concentrating our efforts on helping the teacher do a more thorough job in the field of economics. It is through him that we hope to reach the student.

Q *How does your organization go about the job of helping the teacher communicate economic principles in a classroom?*

A In a variety of ways. In the first place, we have autonomous, affiliated regional councils all over the United States whose job it is to work directly with the schools and teachers in their area. These councils consist of representatives from business, labor and farm groups, as well as academic economists and educators. It is they who arrange for our various workshop projects for high school teachers and students of teachers colleges. At these workshops, we try to acquaint economics teachers with the latest advances in economics. We bring them into contact with experts and, what may be even more important, with other teachers who may be faced with similar problems. It is this give and take which, we believe, is one of the most fruitful contributions we can make to better economic understanding in our schools.

Q *Is there any particular reason why economics was chosen as a field where a special effort of this type was necessary? After all, there are few organizations involved in teaching teachers how to teach history or sociology or English.*

A I think the reason is that the big problems of today are basically economic problems. One of the things that has brought this fact into the limelight was the Employment Act of 1946. If the President was

going to have a committee assess the health of our economy and report their findings to the citizens of the United States, this surely imposed an obligation on those citizens to so prepare themselves as to understand the report.

Q *But the citizen was not prepared?*

A No, he was not. When we first began to survey the field at the end of World War II, we discovered that very little was actually being done in economics education. Teachers were not taking courses in economics, and what economic instruction existed in the high schools was clearly inadequate.

Q *How do you account for this situation? Is there something about economics which is particularly difficult or particularly uninteresting and so requires a special missionary effort on the part of organizations such as yours?*

A Although economists have made a great effort to communicate with the general public, economics, to many people, still seems like a "dismal" science. There are several reasons for this. There is a tendency among economists, as in any other profession, to talk to each other only in technical language. Economics courses, even in the secondary schools, were presented in an overly abstract manner which the average student simply could not understand.

Four hallmarks of economic literacy

Q *Dr. Frankel, in your attempts to improve economic instruction in the schools and eventually in the nation at large, you presumably have some idea of the economically literate citizen. How would you define an economically literate person?*

A I would say that there are four hallmarks of the economically literate person. (1) He realizes that economic problems revolve around the basic fact of limited resources on the one hand and multiple wants on the other. Our economic system attempts in its way to bring about a maximum adjustment of these two factors. (2) The economically literate person can clearly define an economic problem and obtain the relevant information for the valid alternative solutions of the problem.

(3) He should be aware of the economic tools of analysis necessary for arriving at personal economic decisions. (4) He should be aware of various ways in which the social goals of growth, stability, security and economic freedoms may, at different times, be complementary or contradictory. But, in the world in which we live, different groups will tend to emphasize different social objectives and different means for realizing these objectives.

Q *How can we teach the layman to discriminate between various kinds of pressure group economics?*

A It is our job to help teachers in their job of making youngsters into economically literate citizens; it is not our job to provide answers for economic problems. Once an individual has learned where to go for the facts and how to marshall these facts on any particular economic proposition; once he has learned to recognize the basic choices available and the consequences flowing from these choices, he is in a position to make up his own mind on controversial questions. It is a characteristic of a democratic society such as ours that economic questions are basically political. Economic knowledge does not absolve an individual from taking a stand; on the contrary, it imposes a responsibility in the formulation of policy.

Q *Dr. Frankel, as you know, a good many economists have bothered about the average person's ability to make an independent decision in economic matters. The average person, they believe, is in no position to evaluate the "soundness" of the propaganda material he is deluged with. Would you agree?*

A No, I would not. Admittedly, it is very difficult for the average person to discriminate between a statement of economic fact and a plea for a particular policy. But I do believe that we have, over the years, built up a storehouse of knowledge and experience which really amounts to a practical consensus. It is my firm belief, moreover, that as we enlarge this storehouse of knowledge and experience, this area of basic agreement will expand correspondingly. If it doesn't, at least some of the blame will attach to the economists themselves for their failure to communicate with the general public.

Q *Dr. Frankel, your various regional councils consist not only of economists and educators, but also business, labor and farm groups. What do you think these various groups are learning about the general goals of our economic system by being invited, as it were, to take the long-term point of view of the educator?*

A I think they are learning a great deal–and that goes for the educator and economist as well. Educators are responsible for taking the long-range view by the very nature of their profession, forgetting–what interest groups can never forget–that "in the long run, we are all dead." Business, labor and farm groups, on the other hand, may tend to think more in terms of short-run objectives. By being given the opportunity to consider the long-range problem of improving economic education (which will pay big dividends later on) such groups have been brought into very concrete contact with long-range implications and therefore discover and enlarge the areas of agreement.

Q *Wouldn't you say that all education, not only economic education, is a long-term proposition?*

A Of course. By its very nature, education must take a long-term point of view. You start with the youngster in kindergarten, take him through 13 years of formal education–and even then 50 per cent or more of them will go on to further education. It is small wonder that when the educator looks at any proposition it is always from the point of view of what can be accomplished in 10, 20 or 30 years. Education, moreover, is a developmental process. You cannot plan for the first grade without thinking about the second grade and so forth. In education, crash programs are not the answer.

All economic institutions are forced to plan ahead

Q *Do you believe that this kind of long-range thinking, so characteristic of education, is coming to pervade other areas of our society as well? As our economy is increasingly characterized by large enterprises enjoying longer life, does this not require the leaders of our economic institutions to adopt an increasingly "educational" point of view?*

A I definitely think so. Otherwise there would be no reason at all

for the Employment Act of 1946, the Joint Congressional Committee on the Economic Report and all the other steps that have been taken to implement the long-term goals of economic growth, stability and full employment. All economic institutions–government, business, labor unions, farm organizations, etc.–are being forced to make their plans for years ahead. And for this they need the best economic intelligence available to help them in their thinking.

Q *That, certainly, has been your experience in the field of economic education. Do you think that other groups are beginning to feel the same way?*

A Indeed, I do. There are two ways that a pressure group can try to influence policy. It can either inaugurate a crash program designed to get across an immediate point of view or it can look at the long run. Now the trouble with a crash program is that your interests change over the years, so that money spent on a specific short-run objective is often wasted. Now, the advantage of the long-run point of view, which also happens to be that of the educator, is that you are planning for "essential" objectives attainable only in the long run. Your policies are more likely to yield real dividends.

Q *To put it another way, would you say that this long-term emphasis of education is, in fact, the only ultimate arbiter of all the short-term goals that the various interest groups are clamoring for at present?*

A I think so. You know, many of the things that seem awfully important at one time lose a good deal of their significance after a good night's sleep. I think the same principle might be applied to economic problems; many of the crises of the moment may not, from a long-term point of view, be nearly as critical as we think. Witness the late recession. This was a serious recession, but we had sufficient economic intelligence and tools to know and cope with what was essentially a short-term dislocation. That, I think, is the important contribution of our work in economic education. Where are we heading? How can we measure where we are heading? What is it we have to know in order to come to sane decisions? These are the things we have to know and that economic education can help us discover.

Q *Thank you, Dr. Frankel.* ■

Reluctant RECOVERY

by Leonard Silk

If we have emerged from the inflationary recession, we are seeing employment lags that indicate structural maladjustments

■ THE SHARPEST postwar business contraction has also proved to be the shortest. After a 20-billion-dollar drop in gross national product from the third quarter of 1957 to the first quarter of 1958, GNP rose by three billions in the second quarter and by 11 billions in the third quarter. Government economists are currently estimating a fourth-quarter rate of 450 billion dollars, which will break the old record of 445.6 billion dollars attained in the third quarter of 1957.

For two major reasons, however, the attainment of a 450-billion-dollar rate will not be enough to make up all the ground lost during the recession:

•Prices continued to creep upward during the recession. Hence, such a GNP rate in the fourth quarter of 1958 will still represent less output in real terms than did a 446-billion-dollar rate in the third quarter of 1957. It is hard to estimate just how much less, because we do not have a statistical formula that will make allowances for the whole of GNP. The Consumer Price Index, which covers about two-thirds of GNP expenditures, has, however, risen by about 2.75 per cent since the third quarter of 1957. This implies that a 450-billion-dollar rate in the fourth quarter of this year would be less than 440 billions in 1957 dollars. If we also take account of the rise in U. S. population–four million since the third quarter of 1957–per capita GNP will, in the last quarter of this year, be nearly four per cent below its third quarter 1957 level.

•Unemployment, despite the V-shaped recovery, is still markedly higher than during 1957. Unemployment then averaged 2.9 million, or 4.3 per cent of the labor force, including the last three months of the year when the recession was adding to the jobless

rolls. During the first nine months of 1958, unemployment has averaged about five million, or seven per cent, of the labor force. In September, unemployment, reduced further by seasonal factors, was down to 4.1 million, but the Census Bureau's seasonally adjusted unemployment rate was still 7.2 per cent.

The phenomena (of persistent inflation through a recession and persistent unemployment in a recovery) raise some fascinating questions for economic theorists. Is there, indeed, a causal connection between creeping inflation and higher-than-usual unemployment rates? Was the "inflationary recession" responsible for a "depressed recovery"? Or has creeping inflation, on the contrary, been a blessing in disguise; was the slow rise of prices and wages a major factor in checking and reversing the recession? Have rising wage rates contributed to growth and stability by keeping consumption steady, despite the sharp cutback in business expenditures on plant, equipment and inventory?

An old puzzle

These questions can be rephrased in terms of one of the oldest and most difficult puzzles in the history of economic thought: What is the effect of rising or falling wage rates on the level of employment? There are three well-known positions on this question:

•*Cost theory.* Classical economics regards the demand for labor as basically the same as the demand for anything else–a function of its price. Thus, if you raise the price of labor, employers will want less of it. This position, which sees wage hikes associated with higher unemployment, regards wages essentially as a cost.

•*Income theory.* Such diverse economic thinkers as the leaders of the AFL-CIO and the late Henry Ford have held that higher wages will increase labor's demand for goods, and thereby increase employers' demand for labor. This position, which sees higher wages associated with lower unemployment, regards wages essentially as income.

•*Cost-and-income theory.* John Maynard Keynes regarded wages simultaneously as cost *and* income. The Keynesian conclusion is that the rate of wages has no direct effect on employment–but only an indirect effect connected with the rate of interest. The businessman would be encouraged, discouraged or not affected in his employment policy by the wage rates–depending on the cost and availability of investment money, among other factors.

But is there some simpler way of deciding why unemployment

has persisted in this recovery? Can we find an answer without trying to settle complex problems of wage and employment theory? I think we can.

We must make certain that our facts are right–that there is, indeed, something unusual in the behavior of unemployment during this recovery.

Pattern and drag

It is not at all clear that there has been some peculiar pattern or unusual drag in the pickup of employment during this recovery. Many people have been misled by the Census Bureau's seasonally adjusted unemployment rate, which had unemployment reaching its peak in August, 1958 at 7.6 per cent–four months after the April trough in the business cycle–and declining only to 7.2 per cent in September. But, as Census Bureau statisticians concede, there have been serious deficiencies in the way they have made allowances for seasonal adjustments. The government's seasonally adjusted rate has been too low in the early summer and too high in the fall, because the Census method assumes that seasonal changes in the amount of unemployment are are in proportion to the prevailing rate of unemployment. In other words, the Census assumes that seasonal unemployment will be greater, if regular unemployment rises. In fact, seasonal changes in unemployment, resulting mainly from the entry of large numbers of students into the labor force in the early summer, and their withdrawal from the labor force in the fall, have been quite independent of the unemployment rate. A better method used by the Committee for Economic Development, would assume that the swings in unemployment due to strictly seasonal factors are fairly constant in years of high or low unemployment.

When a seasonally adjusted unemployment rate is calculated by this second method, it shows that unemployment peaked at 7.5 per cent in April and declined to 6.7 per cent by September. This shows a greater improvement than indicated by the Census method, which put the peak at 7.6 per cent in August and recorded 7.2 per cent unemployed in September. How does this pattern compare with the recovery from earlier postwar recessions?

The fairly slow reduction in unemployment after the start of the current recovery is quite comparable to the way unemployment behaved during the recoveries from the 1948-49 and 1953-54 recessions. Assuming that seasonal unemployment was constant, we can study previous periods more accurately. At the October, 1949

trough of the first postwar recession, the unemployment rate was 6.9 per cent; five months later, it was 6.5 per cent–about a six-per-cent decline. At the August, 1954 trough of the second recession, the unemployment rate was 5.8 per cent; five months later it was down to five per cent–a 14-per-cent decline. In the recent recession, the five-month decline in the unemployment rate from the April, 1958 trough has been about 11 per cent, or midway between the rates of decline–six and 14 per cent–of the preceding two recessions.

Negative conclusion

Did prices, then, behave in much the same fashion in the three postwar recessions? Did we experience three cases of inflationary recession and depressed recovery? The answer is no. The Consumer Price Index was 103.5 (1947-49 = 100) in November, 1948, when the first recession began. By February, 1949, consumer prices had declined almost three per cent below their 1948 peak. In the second postwar recession, consumer prices were somewhat steadier–but still declining; by the spring of 1955 they declined about one per cent from their October, 1953 peak. But in the last recession, the Consumer Price Index was at 121 in August, 1957, climbed to 123.5 in the April (1958) recession trough, and set a postwar record at 123.9 in July. The net rise was 3.2 per cent. In August and September, with the recovery showing real signs of life, the Consumer Price Index has held at 123.7.

Thus, during the first five months of the 1949-50 recovery, we had the slowest decline in unemployment following the greatest recessionary decline in prices. In 1954-55, we had the sharpest decline in unemployment following a very slight recessionary decline in prices. Now in 1958, we have had an in-between rate of decline in unemployment, with a fairly sharp rise in prices during the recession.

My conclusion is a negative one: that postwar experience will not support any clear and direct relation between creeping inflation –or moderate deflation–during a recession, and the speed with which unemployment is reduced during the succeeding recovery.

To be sure, the level of unemployment rates has been highest in this third postwar recession: for the worst months of 1949-50–from July, 1949 to March, 1950–the unemployment rate stayed within a range of 6.5 to seven per cent. Then, from January, 1954 to February, 1955, the unemployment rate was within a range of five to 5.8 per cent. This time, in the months from February, 1958

to August, 1958, the unemployment rate has ranged between seven and 7.5 per cent–somewhat higher than in 1949-50, and a good deal higher than in 1954-55. What is the cause of this higher rate of unemployment?

Once again, one could attempt to deal with the possible relations among rising prices, employment and unemployment, the impact of productivity on the re-employment of laid-off workers, the increase in the labor force, and particularly the higher proportion of jobs held by women than during the earlier postwar period. One could attempt to explain the institutional rigidities which we have built into the economy.

Such explanations are important, but I believe there is a better and simpler explanation. It is so simple that it is embarrassing: this recession was more severe than either of the earlier recessions, and hence unemployment was greater. Until recovery carries us well beyond previous GNP levels, we are likely to see unemployment persist at levels higher than those we enjoyed earlier in the postwar period.

It is probable that full employment is harder to attain now because of the large investment in more efficient plant and equipment. Institutional changes, giving more power to the great corporations and unions, have also affected price and wage policies in a way that slows employment responses to increased production. All this means that we are going to have to grow faster than formerly to restore full employment.

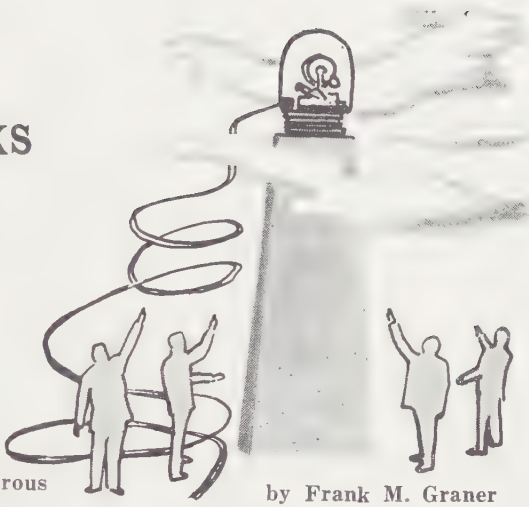
I do not find inflationary recession to have been the cause of depressed recovery. Rather I suspect that both creeping inflation and the persistence of unemployment at higher rates than we like have been caused by the same mixture of institutional changes, and price and wage rigidities. Studying these changes in the structure and functioning of the U. S. economy–and prescribing ways for reducing their simultaneously inflationary and growth-reducing effects–is the difficult duty before us.

But institutional modifications are not going to be accomplished overnight–or, possibly, even within a decade. The obvious and immediate way to end remaining unemployment is to get total national output up 30 or 40 billions of dollars above its past peak level, and try to keep it growing. ■

Money Attracts Money

IN RHODE ISLAND, a new bank branch displayed one million dollars in currency in a lobby showcase. Entranced by the attractive crisp green pyramid, and assured of the bank's solvency, customers swamped the bank with new accounts.

Will Stocks Stay Up?



Inflation may have the contradictory effect of stabilizing the stock market at levels that formerly seemed dangerous

by Frank M. Graner

■ THE PROFESSION of investment analysis, while relatively new, has grown rapidly in response to the increasing complexity of the investment market. New demands of an expanding economy and, specifically, such new structural elements as institutional investment are responsible for the changes. Little attention was paid to statistical analyses when the individual investor was dominant, but today the managers of billion-dollar funds spend millions in detailed research.

If investment decisions are now more sophisticated, they continue to deal with a situation of chance and must compromise with the imponderables. It is easy to find two highly competent investment counselors disagreeing completely about the potentials of a given stock. We can never expect security analysis to arrive at a stage where we shall know precisely whether Du Pont is selling too high at 205 dollars a share. The progressive diminution in market fluctuations since 1929, however, suggests that wiser investment policies have been conducive to stability. More accurate analyses could bring the investor into the market sooner when it is depressed, and encourge him to reduce buying pressure when it is inflated.

Many people nevertheless are worried today because dividend yields are low even as stock prices continue to rise. Has the

greater sophistication in detail not been matched by superior wisdom in basic investment philosophy? Does it make good sense for the investor to risk market perils for a three-per-cent annual dividend? We must inquire into the nature of investors' criteria and the changes they have undergone.

An artificial value

Many years ago, book value–the liquidating value per share of stock if all the company's assets were sold and debts paid–was the major factor in determining whether a stock was overpriced, reasonably priced or underpriced. If a stock were selling much below its book value, it was considered in the buying range; if a stock were selling much above book value, it was considered too high in price. This criterion fell into disrepute primarily because the market itself did not substantiate this thesis.

In 1929, the most conservative advice recommended railroad stocks, presumably on the basis of book values. Today most major railroads sell at a fraction of their book value and still do not represent good investment opportunities. It became apparent to many analysts that book value was an artificial value which, even if stated correctly, reflected value only in case an operation were to be liquidated. The investor does not ordinarily buy into a company to witness its early sale or dissolution, and book value does not reflect its real present value. Goodwill created through gaining consumer acceptance for a given product sometimes exceeds the book value itself. While book value is a static concept, business is dynamic and the fortunes of a given firm respond to all the erratic effects of commercial life.

Analysts now look at the operating statement as the essential value determinant. A generally accepted thesis today prefers to consider earnings per share instead of book value per share, and it is not existing earnings but anticipated earnings which determine current prices. Consider the situation when company A earns the same amount per share as company B, but A anticipates doubling its profits while the earnings of B are to remain stable. The market place would reflect this by paying twice as much for the stock of company A as it does for the stock of company B. The analyst is thus looking at the price-earnings ratios and making allowances for potential growth. This statement of the analyst's approach is obviously oversimplified. The analyst has merely defined the problem when he brings potentials into his calculations; the great unknown is what these profit potentials will amount to over the years.

Currently, then, earnings are considered the major criterion for determining intrinsic values. The next question is: How much should an investor pay for a given dollar of earnings? This has a direct relationship to the returns which can be earned on other types of investments and also to the emphasis that the investor may place on dividends versus appreciation. Currently, stocks are selling for an historically low dividend yield in relation to price per share. Some stocks are even selling for a lower yield than the bonds of the same company. Does this mean that the stocks are selling at too high prices? The answer is not necessarily affirmative.

Inherent risk

Of all the various formulas which are used by different investors, one of the more meaningful has been the relationship between stock and bond yields. Theoretically, stocks ought to return more because of the added risk inherent in a stock investment. When stocks sold so high that their yields approached the level of bond yields, it was thought that stocks were selling too high. In 1929, stock yields actually fell below bond yields. This was followed by a sharp market break. In 1937, the peak of the next bull market, the insignificant differential between stocks and bond yields presaged another market break. A somewhat similar situation occurred in 1946 and again in 1953, but the breaks of the latter years were progressively less severe. The theory behind the stock-bond investment criterion is that the investor will shift out of stocks and into bonds when the differential between the two yields is not sufficient for him to accept the added risks of equity investments. This assumes that the investor is almost exclusively interested in yield.

The great emphasis on inflation, however, has changed calculations. The progressive devaluation of savings through inflation has led the investor to feel that his only protection is in rising stock prices. Thus a factor other than yield influences him, and he becomes less concerned with low stock yields, even when they decline to the yield level of high-grade bonds. He knows that bonds do not afford the investor any protection against inflation.

Another major factor is the tax problem which discourages the large investor's interest in high yield stocks. Trying to avoid high income taxes, he would prefer to take long-term capital gains where his tax liability at present is limited to 25 per cent. Variable annuities represent another response to the tax and inflation situation; life insurance companies

and pension funds are considering them seriously. Here the emphasis shifts away from income and toward appreciation, with the added advantage that the dividends of growth companies will increase as their earnings increase. Future dividends will represent a good return on original cost even though a good growth company would never sell on a high current dividend yield. If this investment thinking is correct, then stocks today are not necessarily too high, and we must change our ideas as to what determines intrinsic values. We must thus be willing to pay higher multiples for a given dollar of earnings than has been true in the past; the point is to find a growth potential that will protect the principal against invasion by price rises.

Several factors are important enough to justify re-examination of current benchmarks. General investor psychology is one. Experience since the end of World War II has been much more favorable for common stock investors than for investors in fixed income securities. Investors are becoming more and more aware of the dangers of inflation and are seeking protection in common stocks. This is shown by the fact that many U.S. Savings Bonds have been redeemed in advance of maturity, while new purchases have been disappointing.

In addition, the experience of investors in negotiable bonds has been poor. Long-term government bonds were selling 10 per cent or more below par when the Federal Reserve began to ease money in the fall of 1957. During the following few months there was a sharp rise in the bond market, with gains of 10 or 12 points. But with the first recovery signs, interest rates began to rise again and governments fell to their old lows. Even had investors purchased bonds at their lows, they would have merely witnessed a rise and subsequent fall to their original level. And for those who may have purchased bonds near their highs –perhaps because of some misgiving about stock values in light of business conditions–the experience has been disappointing. The bond market has not been a stable haven for funds awaiting a lower stock market level.

Size and growth

Investors are also conscious of the size and the growth of the government debt. Not only have we not been able to balance the budget very often during postwar years, but the deficit anticipated for this fiscal year is in the magnitude of 10 to 12 billion dollars. The inflationary implications are obvious. Other established inflationary forces include continual wage increases even during a pe-

riod of depressed business activity. The fact that the cost of living was achieving record highs during the recession of 1957-58 must have impressed a good part of the investing public.

Institutional interest

Another important factor is the magnitude of new investment money compared with a relatively limited number of shares of good companies. Institutional interest in common stocks has mushroomed since the end of the war. The pension fund of American Telephone and Telegraph Co.–one of the largest pension funds in the world –only recently stated that up to 10 per cent of the funds would be invested in common stocks. Previously, no common stocks were held in the fund. This is merely one example of the trend in the thinking of pension fund management. If insurance companies begin to sell variable annuities, they will represent a new demand for common stocks.

This new money bidding for common stocks finds only a relatively limited supply of shares. Few companies whose stocks have investment merits have done enough equity financing during the last decade to absorb the net increase in demand. They would prefer to get money through bonds because bond financing means less taxes. Moreover, stock held by many institutions is put away and does not represent part of the floating supply. Stock splits have been numerous and this has eased the situation at times, but only temporarily. As long as the relative cost of equity versus debt financing–dividend versus interest payments –is substantially offset by the tax advantage of debt financing, not much new equity financing appears in sight. Some new equity financing might be undertaken if interest rates continue to rise and stocks sell at progressively higher prices, but there is no evidence of a trend like this at present.

One interesting phenomenon of the 1958 bull market was the extent of bearish sentiment which still exists. This means that there are substantial funds awaiting a better time to purchase equities, thus representing a buying cushion should the market sell off to any degree. This is quite a different market from the 1929 market where the psychology was almost uniformly bullish.

The situation of lower yields per investment dollar appears to be a rational response to present economic verities. While the short-term outlook may not justify this year's stock rise, the longer-term outlook for the economy is bright, and market levels four or five years from now will probably justify commitments in equities even at current levels. ■

seasonal symmetry

The pace of the expansion has slackened from its midsummer heat. If the effect was not chilling, autumn has given a lukewarm character to the recovery. From April to September, employment had regained only one-quarter of the loss incurred in the preceding nine to 10 months. Personal income continued to rise steadily, but consumers were displaying a neatly paced restraint in transforming income into purchases. Thus, if personal income in September was two per cent above the same period's level of last year, retail sales were down an equal percentage in the September-to-September comparison. This four-per-cent spread was showing up in durable goods. Consumers had more money but were still postponing the postponable purchases, thus maintaining the established symmetry of their contradictory response to production figures. They had not been panicked into a buyers' strike during the slump, and they were not now rushing to bid up the boom.

fair autumn

The businessman-as-consumer was similarly mod- erate. Inventories still had a negative effect, although the liquidation rate was much reduced from that of the year's beginning. The annual rates per quarter for the first three quarters were, respectively, 9.5, eight and four billion dollars. Even if the last quarter should show another reduction, business is still refusing to replace as fast as it sold.

inequities of wealth

Corporate profits were rising encouragingly, although they had failed to reverse the liquidation rate in inventories. A survey of 300 corporations reported gains in this year's third quarter over the same period of 1957. But third-quarter profits were at a rate still 13 per cent below total 1957 profits, albeit an enormous improvement from the 33-per-cent drop in the first quarter. The 13-per-cent figure compounded some instructive disparities. It canceled out gains of 30 per cent in railroads, 29 per cent in textiles and 26 per cent in utilities; it powerfully reflected drops of 98 per cent in automobiles, 35 per cent in coal and 24 per cent in iron and steel. A moderate recovery in the automobile sector, generally expected because of a flurry of restraint-whetted demand, should have a strongly buoyant effect on aggregate corporate profits.

indwelling

Industrial sales were slightly above last year's levels, and manufacturers were expecting a five- to eight-per-cent rise next year. Capital expenditures rose during the present quarter to an annual rate of 31 billion dollars, according to experts' projections, after a rate of 30.3 billions in the third quarter, and industry planned to increase the angle of ascent through next year. The sum of hopes and plans meant a cautious resumption of the nation's long-range growth pattern after the recession hiatus. But business seemed to be more responsive to immediate cost-and-profit factors, which fortunately confirmed the major trend. Thus, there was no significant activity depending on inflationary expectations. Business had not yet begun to speculate on the economic consequences of the elections, preferring to dwell on its modest profits rather than on wide-angle predictions.

response in the round

Exports were rising in a complicated response to changes in domestic conditions. The annual export rate for the first half of 1958 was 16.5 billion dollars, an 18-per-cent drop from the same period of 1957. But the latter half of this year should bring the rate to an even 17 billions. The rise was due to the liquida-

tion of American goods in foreign inventories and the consequent need for replacements, an increase in our customers' gold and dollar reserves, and the effects of the American recovery on the market for raw materials. We were buying more from the rest of the world, and the results were as heartening as they were instructive in the principles of international trade. Export improvements included a six-per-cent rise in machinery sales. Our imports had dropped to an annual rate of 12.6 billion dollars in the first half of the year, four per cent off the same period of 1957. The second half of 1958 should see a modest rise to a rate of 12.8 billions, but experts predicted a five-per-cent rise in 1959.

medical inventory

The economy was lacking neither in stimulants nor depressants. We had excess capacity and a secular growth rate, unemployment and high personal incomes, inflationary prices and disinflationary buying. It would remain for any one factor or combination of factors to take the initiative in establishing its direction as the trend of the whole.

* * *

recessed recovery?

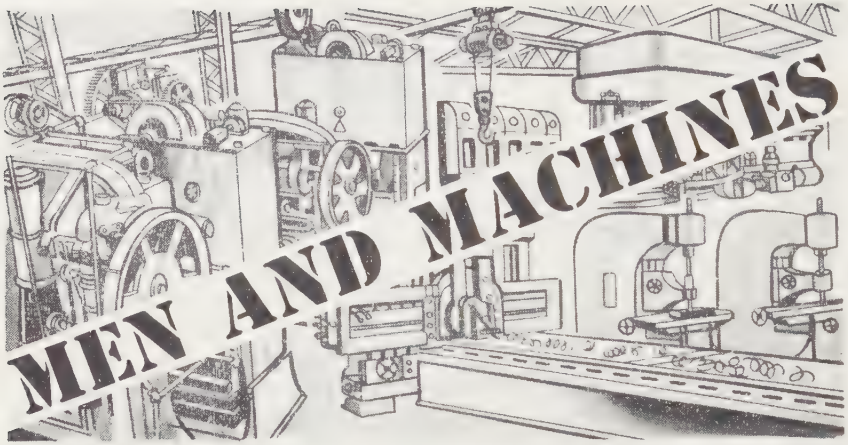
WASHINGTON—Government economists aren't saying so in public, but there is a body of evidence accumulating which points to a very slow economic recovery–possibly even a relapse. This means that all government and business plans, only recently predicated on a quick recovery, will be knocked into a cocked hat unless the economic indicators start showing some sharp upturns shortly after the new year. A growing labor force, basic conflicts over the wage-cost components of business and the ever-increasing costs of government–these are the chief contributors to inflation and the constant irritants for the private sector of the economy. There will be real trouble ahead if the pickup in the spring is not as encouraging as it was last July. Right now the signs for early '59 are not that good.

upstream economics

When Congress convenes next January, there will be an unusually varied array of unpleasant tasks facing it. Among these will be the problem of taxes. In the recent past there have been frequent attempts to develop a formula for a tax cut. From now on the talk will be the other way, and no one really believes that a hike in federal gasoline taxes will be the beginning and end of it. Our biggest peacetime budget has a 12-billion-dollar hole in it which cannot be allowed to be duplicated, à la Swiss cheese, in future "record" budgets. This is why a slow economic recovery is so dangerous right now. A tax hike in the midst of a recession is like asking a whale to make its way up a mountain stream. Something is bound to give, and what it will give in to is some sizable deficit financing. This kind of resolution of our economic problems does not put us in a good position to fight the economic cold war declared by the Russians.

a decade of headaches

The grand strategy for world conflict during the next decade has been set. Once again Russian initiative has set the time and place, and the best we can now do is plan counterstrategy. Khrushchev has spelled out the goals of Russian economic development, which means that for every period of economic slowdown in the United States the USSR increases its chances of closing the gap between the two countries. Already economic considerations have forced us to rely less on our allies. A return to "fortress America" is now in the making, with the ICBM emerging as our primary weapon. Next, Europe must deploy more of its own resources for defense, thus slowing its economic growth. In the meantime, the "synchronization" of Communist economies moves ahead ruthlessly. Then will come the inevitable "peripheral" wars, forcing us to extend ourselves again. Russian strategy: destroy the logic of Western institutions. Our counterstrategy: hard work, a friendly, united Southeast Asia, a greater emphasis on the role of the individual and less on the "wonders of our system." Aspirin sales: going up. ■



If machines have brought monotony to the factory, they open still unexplored ways of combatting that monotony

by Arnold S. Feldman

■ EVER SINCE Adam Smith singled out the division of labor as the original source of economic wealth, an increase in the one has frequently meant an increase in the other. Indeed, if a third factor is added, the association becomes perfect. This third factor is, of course, the machine.

In societies thoroughly committed to the use of machines, both wealth and the division of labor have increased in an overwhelming manner. Smith's contemporaries could not have imagined the level of wealth and degree of specialization typical of most industrial societies today. If they had, one wonders if the fantasy would have appeared as grotesque to them as the reality appears to many thinkers of our own generation. For what was first conceived as a doctrine of original wealth is now considered by some as a doctrine of original sin.

Social critics have viewed the division of labor in modern industrial societies as excessive at all levels of the social system. The general principle is that as specialization narrows occupations, the minds of men are forced into equally cramped molds. This view, however, is less pessimistic in regard to the upper ranks of the social system, where specialization results from the spread of scientism. Some critics, nevertheless, feel that the concept of the "com-

plete man" is as valid an ideal for the modern intellectual and manager as it was for the Renaissance philosopher and king. An increasingly popular antidote for managers is an intriguing amalgam of classical studies and training programs in the manipulative skills of human relations.

The effect of specialization is infinitely greater and thus more disastrous in the lower occupational ranks. If narrowing work to a single occupation restricts the minds of men, then narrowing work to a single physical act might destroy the ability of workers to think.

An assessment of work stultification is complicated by many factors. The question of values is, of course, primary. We can deal with this difficult problem by making the perhaps easy assumption that mental provincialism and sterility are bad and that active creative minds are good.

The second complicating factor is the problem of causation. Assuming that industrialism and its concomitant increasing division of labor are associated with many social evils, how much of this association is machine-determined, and how much has resulted from the varied ways in which entrepreneurs and managers have used the new technologies? Many of the social evils commonly attributed to industrialism and increasing division of labor antedated both and continued on into the factory. This can happen because alternative patterns of work are possible even within standardized and mechanized factories. Men, not machines, choose among these alternatives.

The third complicating factor is the criteria, or the rules of evidence, employed in measuring the effects of increasing division of labor. Many critics of the industrial system have prejudiced their own case by using the preindustrial organization of work as their standard of comparison. Such a comparison contrasts the debased and automatonlike character of factory work in the industrial urban slum with the independent peasant and artisan character of work in the rural village or craft center. Regardless of the merits of the first part of the comparison, the second half is greatly distorted. There is little evidence to indicate that peasant life provided great or even moderate amounts of mental stimulation. Subsistence itself was often so problematic that there was very little energy left over for other activities. Indeed, the peasant society is the archtype of the stagnant economic and social system.

Comparisons with preindustrial craft centers are often equally inaccurate. Many of these idyllic manufacturies, on closer examin-

ation, turn out to be rural sweatshops. The "cottage system of production" may provoke the mental image of neatly thatched dwellings set down amidst a rolling English countryside; but they were more likely to be hovels of the most primitive type. Nor did the system of putting out work yield more freedom to the worker than piecework does today. The rates of production necessary for an adequate income usually required long and arduous labor by all members of the family. The fact that the foreman was also the father does not make child labor more wholesome. The "good old days" were just not that good.

Case in point

Nevertheless, merely pointing out that industrialization did not mean a wholesome deterioration of working conditions is insufficient. Distortion of one-half of the comparison does not automatically destroy the validity of the other half.

An additional factor is the simplistic way in which increasing division of labor is viewed. All too frequently it is seen as a unitary process. Actually, several different processes are involved, and they frequently form what can be properly termed a dialectic. A case in point is the relationship between skill levels and increasing division of labor.

The loss of skill or craft is often cited as the major evil associated with increasing division of labor. Many other degradations are said to follow the loss of skill, like the loss of pride in work and self. It is certainly true that skill dilution is one of the ways in which the division of labor increased as crafts were divided into many jobs of minimal demands. But skill dilution is only the first stage of the dialectic, the thesis.

The antithesis is the creation of many new and highly skilled jobs. Thus, as assembly-line production of automobiles destroyed the carriage makers' craft and many others, it inevitably created a demand for large numbers of tool and diemakers, designers and mechanics. The result or synthesis has been a net increase in the skill levels. The increased demand for skilled workers contributed, in turn, to the need for a mass educational system, and encouraged the discovery of talents which otherwise would have been wasted. It is true, nevertheless, that a significant segment of the labor force is still employed in the dull jobs. Are these workers inevitably becoming automatons?

A common answer is that these developments are the price society pays for social and economic progress. This answer is clearly unacceptable. The price is exorbitant for our society because it contra-

dicts and thus threatens many of its most important values. The isolation of a significant segment of the population is much too wasteful of important abilities and talents. Those societies in which it has occurred have been economically stagnant and politically unstable.

Most important, the acceptance of such a dehumanization is based on the same principle invoked by the critics of industrialism. This principle–that the narrower the job the duller the mind–is wrong because it concentrates on only one of the worker's economic roles, that of producer. The other major economic role, that of consumer, is ignored. There is no reason to suppose that time spent at work has a greater influence on mental sensibilities than time spent away from work. Certainly the time spent at work occupies a decreasing proportion of a worker's life. This decrease is a long-term secular trend, and the results of recent labor-management bargaining show that it will continue.

Significant consumption

The worker's consumer behavior has, of course, become more varied along with the division of labor. He now consumes significantly greater amounts of both goods and services. His nonwork environment is incomparably richer in stimuli. Again, Adam Smith may be profitably invoked. Although inequities in the distribution of income remain, the worker has significantly shared in the wealth increase produced by the division of labor.

The items of worker consumption may not maximize his intellectual growth, or rather they may not be those the intellectual would have him choose. Indeed, the critic of industrialism often decries the "despiritualization" of workers. This latter complaint is closely related to the fear that increasing division of labor will turn workers into automatons. Both are based on the view that workers are almost totally vulnerable to corruption by environment.

The conception that workers are passive victims of industrialism on and off the job results from a confused image of the American worker. It assumes that the worker's personality lacks sufficient strength to withstand the various pressures to which he is exposed. At best this image of the worker is patronizing, and at worst it is insulting. In any case, it is empirically wrong. The worker has influenced conditions of employment both individually and collectively. Collective action has been the more visible. It is interesting to note that the most virile unions are commonly found in industries where standardized production is the rule.

It might be profitable to examine some less extreme consequences of a machine-determined division of labor. The actions characteristic of the factory labor are machine-paced and rhythmical. Machine-pacing devaluates the worker's volition relative to the demands of the machine. The worker reacts to leads initiated by the machine. Pacing imposes a rhythm on the worker's actions even after production goals are established, because the machine's ability to vary the periodicity of its acts is limited. Frequently this rhythm is more complex than the casual observer would suspect in that different and varied acts are involved. The various acts are combined into a set pattern analogous to a stanza, and succeeding stanzas are exact duplications of each other. This form of labor is monotonous and undoubtedly dulls worker's sensibilities.

One proposed solution is the redesigning of machines to make the stanzas less regular, less repetitive, but this is merely a palliative in that it does not alter the basic situation. The worker is still reacting to the demands of the machine, although these demands are more capricious. Moreover, this solution maintains the definition that the problem is purely technological, purely machine-determined. Any solution must recognize that the relationship between worker and machine depends in part upon the worker's perception of this relationship and of his role in it. The point is that workers, as well as machines, can be changed.

This could be done by redefining and increasing the training period for workers, permitting the labor force to become more flexible and interchangeable. Thus, the workers would become more independent of any single machine. They could then be periodically reassigned to different machines. While this program would increase labor costs in the short run, it might have the opposite effect in the long run. The nature of technology is highly dynamic, and a multivalent training program might reduce some of the labor costs associated with periods of radical technological change. It would, moreover, change the worker's definition of the interaction between himself and the machine, and it could permit the worker to ascribe to himself a more worthwhile role in this relationship.

If these conditions show that the problem of work stultification cannot be verbalized out of existence, they do demonstrate that much can be done by determined study and experiment. A shift in emphasis from the mechanical to the moral could be justified in terms of long-range efficiency. ■

the union as capitalist

Growing funds have forced unions into investment operations that require a banker's skill–and temperament

by Nathan Belfer

■ TRADE UNIONS, with assests of two billion dollars, are big business but they are only slowly admitting it to themselves. While they are keen observers of the economic scene, until recently the unions did not use their funds to participate seriously in the nation's industrial development. Six years ago, 85 per cent of union holdings were in cash and government bonds. Most of the remainder was in real estate, mortgages and savings accounts, while less than two per cent was invested in common stocks.

The situation has changed markedly in the past two years. The well-managed Retirement, Health and Welfare Funds of the International Ladies' Garment Workers' Union, with assets of 210 million dollars, kept all their investments in government bonds until a few years ago. The union has since begun purchasing Veterans Administration and FHA mortgages. More significantly, the union's general executive board recently authorized the investment of five to eight per cent of the funds, about 17 million dollars, in corporate bonds. The ILGWU is now emphasizing the growth feature. In 1957 receipts of its social funds amounted to 71 million dollars against disbursements of 49 millions–providing a 22-million-dollar surplus for new investment.

The International Brotherhood of Electrical Workers has more than 50 million dollars of its pension and life insurance reserves invested in VA and FHA mortgages. The United Mine Workers Union has bought control of two banks in Washington, D. C.

Conservative investors

Other unions are similarly investing in VA and FHA mortgages and making modest incursions into the stock market. The National Brotherhood of Operative Potters, a small organization of 25,000 members, has become a sanguine exception with 70 per cent of its assets in common and preferred stocks. The usual motive for union stock purchases is not investment; ownership of a few shares means that the union will receive the corporation's reports and can send representatives to stockholders' meetings.

The unions persist in being conservative investors, but they are no longer restricting themselves to government bonds. What has caused this change? What significance does this have for union members, corporations and the public?

Union leaders are political personalities. They have usually risen to their positions through union struggles that had little relation to finance and investments. This was no training for money management; indeed, they were strongly influenced by a lingering mistrust of banks, brokerage houses and other financial institutions. A policy of bond investments seemed safe and required little thought or financial skill. The union leadership, moreover, did not have to be apprehensive about membership criticism, as it would if riskier holdings lost value.

Unions are just beginning to catch up with other organizations, who had modified their investment policies several years earlier. In 1950 the New York State Legislature adopted the "prudent man" rule, which said that the investment of as much as 35 per cent of trust fund assets in common stocks was consistent with prudence. The Legislature later allowed insurance companies and savings banks to invest three per cent of assets in common stocks. A recent Securities and Exchange Commission survey found that self-insured pension funds, with assets of 19 billion dollars, had only 10.5 per cent in government bonds, 53.8 per cent in corporate bonds, 24.8 per cent in common stocks, and the balance in real estate, mortgages, cash and preferred stocks.

In September of this year, the pension funds of American Telephone and Telegraph Co. began to buy common stocks. Totaling 2.6

billion dollars, their assets had formerly been invested in high grade bonds for the most part. The funds have been authorized to place up to 10 per cent of their holdings in the more speculative issues. The pension funds of the City of New York and the State of New Jersey are now buying some corporate bonds instead of just government bonds, and universities and foundations are also shifting investment weight from government to corporate bonds and common stocks. The various funds thus are shifting a few paces from their old positions. If they were mildly liberal before, they are becoming more liberal; if they were rigorously conservative, they are now mildly conservative.

Power of inflation

Inflation is the power behind the change. The low yields of safe bonds were insufficient to compensate for their loss of value in relation to the inflated cost of goods. The higher yields of four per cent from mortgages and corporate bonds were tempting. One and one-half per cent more in yield on reserves of 100 million dollars means an increase of 1.5 million dollars in annual investment income. Actuaries estimate that a one-per-cent yield increase on pension fund assets would raise benefit payments 25 to 30 per cent.

"Safe" bonds, moreover, are not completely safe. Changing interest rate conditions can cause a considerable decline in bond prices. Many unions bought large amounts of 2.5-per-cent government bonds, which are selling for little more than 90 cents on the dollar. Although the government will pay 100 per cent at maturity, the unions are carrying a paper loss that reflects the low yield.

Unions reacted slowly and painfully to the necessities of the changing situation. They had to alter fundamental attitudes about risk and safety. President David Dubinsky of the ILGWU was careful to point out that his union's policy change was not dictated by a desire for speculative profit. He has emphasized the defensive nature of his union's actions.

Unions have also recognized the need for professional fund management. Many retain banks and investment firms as advisers, or they actually hire investment personnel. In his two years with the ILGWU, the union's finance expert has already achieved a substantial yield increase on its holdings.

The effects of these new union policies extend well beyond benefit increases for retired workers. If unions buy stock in companies with which they have bargaining agreements, their ownership position could work a transforma-

tion in industrial relations. Unions could become a strong management factor as well, but the possibility of a truly dominant role for unions seems remote. While union assets are considerable, they are small in comparison to those of the larger corporations, too small to give the unions a controlling share in American industry. It is furthermore doubtful that the unions would follow such a policy, even if they could. Unions have preferred to avoid the responsibilities of managerial decision-making. Their liberalized investment policies have been directed toward bigger financial returns, not managerial power.

Negligible impact

Exceptions have occurred. The International Brotherhood of Teamsters, which has been active in a number of areas, invested in Montgomery Ward and Freuhauf Trailer, and promptly took sides in battles for control that were going on in those firms. Other unions may discover that their distaste for such struggles may not be enough; they might be forced to use their voting power in given management situations in order to protect their investments. Proxy fights, for example, create circumstances where nonintervention itself becomes a decision on management policy level, even if it is a negative one.

Union funds have had a negligible impact on the capital market. They have made more money available for housing and business in general through their mortgage and corporate bond purchases. But restrictions on the purchase of common stocks will reduce the effect on the stock market; other financial intermediaries like the insurance companies and savings banks have more money and less official inhibitions in buying common stock. These nonunion funds will add to the institutional supports for the stock market in a magnitude the unions will never reach.

Unions are recognizing that their previous policy of exclusive investment in government bonds was a negative one. The recent moves away from overcautious conservatism were wise and should lead to sounder investment programs. As unions employ more expert advisers, their policy can be expected to be further relaxed. The direction will remain conservative: high grade corporate bonds, mortgages and union-sponsored housing projects. Increased investment in common stocks does not promise to become a factor of magnitude.

If unions are becoming more businesslike, they show no inclination to participate in the more speculative side of the American economic adventure. ■

THE PERMANENT FRONTIER

No. 11: the effects of slavery on the economy of the South and on the interests of an expanding nation

■ FOR SEVERAL DECADES before the 1850s the South had played an important if not determinant role in the *national* government. But the rapid economic and social transformation of the North and the West after 1843 doomed the South and its "peculiar institutions" to minority status in the Union. Not that the South's economy was stagnant after 1843. More and more cotton was exported, and in 1859 more than half of the value of American exports was in raw cotton. Three-fourths of the Southern cotton crop came from the Gulf states and Arkansas. In 1859, no less than 4.5 million bales of cotton came from Southern farms and plantations. The tobacco crop, moreover, doubled between 1839 and 1859.

The expansion of Southern agriculture hardly offset the economic boom in the North and the West. The railroad industry encouraged economic development in those two regions, and on the eve of the Civil War nearly 1.5 billion dollars, or more than 25 per cent of the nation's active capital, was invested in iron rails and rolling stock. In 1860, Michigan and the states in the Ohio Valley, with 11,000 miles of track, had more railroads than the Middle Atlantic and New England states combined. The value of the nation's manufactured product increased from a little over one billion dollars in 1850 to nearly two billion dollars in 1860.

Similarly, Western agriculture –the production of corn, wheat and pork products–increased spectacularly. The growing population in the East and the needs of the European community created new markets for these foodstuffs and encouraged mechanization and specialization, while improved transportation brought the mar-

kets of the East and the West closer together.

Eastern capital financed Western railroads, and Eastern credit directed the movement of Western agricultural goods. By 1858, New York, Boston, Philadelphia and Baltimore were connected by rail with Chicago, Cincinnati and St. Louis. The old trade connections between the South and the West were not entirely broken, but the great bulk of the new agricultural surplus of the West now traveled eastward.

In 1850, the West shipped 3.6 million bushels of corn to the East and 2.4 million bushels to the South. Ten years later, 19.2 million went East, while the South got only 4.8 million bushels. The statistics on wheat shipment were even more revealing. Only 500,000 bushels went South in 1850 and 10 times that amount was sent to the East. In 1860, the South received 580,000, but the East got no less than 28,420,000 bushels.

Three million immigrants

Between 1844 and 1854 almost three million immigrants came to the United States. Mainly Irish and German, most of them shunned the Southern states for fear of competition with cheap slave labor. They were attracted by the opportunities in agriculture, industry and transportation in the free states. In 1860, 30 per cent of the residents of Minnesota and Wisconsin were immigrants.

The South knew that it was losing its place of power in the national government. In the early 1850s the free states had 144 members in the House of Representatives, while the slave states counted only 90. The precarious balance between slave and free states in the Senate had ended in 1850 when California entered the Union. Soon after, Oregon and Minnesota also came in as free states, while there were no new slave states.

The South's consciousness of its gradual loss of national power came at the same time as the slave interest faced pressing economic problems. Cotton and tobacco farming used up land quickly. Thus, the South counted more abandoned farms in 1850 than did the New England states, and the planters, with a relatively heavy investment in slaves, needed fresh lands. Southerners also complained that although cotton production had risen spectacularly, Northern control of the carrying trade reduced their margin of profit.

More to the point, and this was especially true of the lesser plant-

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This is the eleventh article of a series in CHALLENGE which deals with the history and development of the United States economy.

ers, costs of production rose more rapidly than the price of cotton. Farm implements and freight charges were more expensive than before, and the price of slaves increased steadily after the middle 1840s. The expansion of the plantation system, the use of slaves in nonagricultural pursuits and the halt of the slave trade combined to widen the gap between supply and demand. A prime field hand who cost 600 dollars in 1845 sold for between 1,200 and 1,800 dollars in 1860, and the ratio of cotton prices to the price paid for a prime field hand in these years fell steadily.

Peculiar institutions

Many leaders in the South, therefore, pondered a simple question in the 1850s: How could the South protect its "peculiar institutions" and solve its economic problems when the sectional balance was being upset by economic development?

The South still had supporters in the other sections—especially in the southern Ohio Valley and among the cotton manufacturers and financiers of Eastern cities. But was this enough? The emerging alliance between the upper Northwest and the Northeast had to be broken or, at least, weakened. But the South had to make concessions to the farmers of the Northwest. The farmers wanted cheap land, a federally sponsored national railroad and federally aided river and harbor improvements. Should the South offer cheap land when that meant the expansion of the free states and greater sectional imbalance? Should the South sanction a railroad through the free states and thus hasten their development?

The leaders of the South rejected these alternatives and instead tried to check the expansion of both the North and the West, while expanding the slave system itself. Their four-point program also included reforms that would have freed the South from domination by the Northern financial and mercantile community:

- At a series of commercial conventions, Southerners talked of bringing railroads and manufacturing into the South. Many of the lesser planters advocated a reopening of the slave trade. Direct trade with England, Southerners hoped, would retain that part of their surplus lost to the Northern mercantile and financial community.
- The South sought to check the expansion of free agriculture in the West and industry in the Northeast by opposition to protective tariffs and the cheap distribution of federal lands. The low tariff of 1857 and the defeat of several homestead, or "free land," laws was the result.

•Southern extremists advocated territorial expansion outside of the United States, hoping to add new slave states and redress the sectional imbalance. They coveted Mexico, planned to seize Cuba and turn it into no less than five slave states, and even talked of annexing parts of Central America.

•Most important, they sought to open certain regions within the country to additional slave labor. Stephen Douglas, the Democratic Senator from Illinois, wanted to organize the territories into states. Transcontinental railroads and the value of Chicago real estate depended on the passage of such legislation. Douglas needed Southern support for his legislation and reckoned that the South would give up its desire for a railroad in exchange for a slave state. The Missouri Compromise of 1821 had provided that new states entering the Union would be equally divided between free and slave states; the Kansas-Nebraska Act of 1854, supported by Douglas, repealed the Compromise in effect by permitting the settlers to decide if their state would be free or slave.

Passage of the Kansas-Nebraska Act and the general efforts of the South to check Northern and Western development had a cataclysmic effect. The issue of slavery in the territories was now national, the Whig party disintegrated, and the Democratic party lost its national character as Northern and Southern Democrats clashed. The repeal of the Missouri Compromise and the South's program of expansion sealed the political alliance between the Northwest and the Northeast. The Republican party, sectional in make-up, was the offspring of the Kansas-Nebraska Act.

Competitive threat

Where opposition to slavery had been largely moral and nonpolitical in character before 1850, Western farmers, small businessmen and immigrants feared the competitive threat that the slave system offered them; self-interest drove them into the Republican ranks. Speaking in Peoria in 1854, Abraham Lincoln insisted that the territories were meant to be "homes of free white men." "This they cannot be," Lincoln went on, ". . . if slavery shall be planted within them. Slave states are places for poor white people to remove from, not to remove to. New free States are the places for poor people to go to, and better their condition. For this use, the nation needs these Territories." Two years later, Lincoln added: "Let us draw a cordon . . . around the slave states, and the hateful institution, like a reptile poisoning itself, will perish by its own infamy."

Seizing on the grievances of Northerners, the Republican party advocated free land, a protective tariff and federally sponsored internal improvements such as railroads. After the "panic" of 1857, Northerners flocked to the new party because many of them believed that Southern opposition to homesteads and a protective tariff blocked economic recovery.

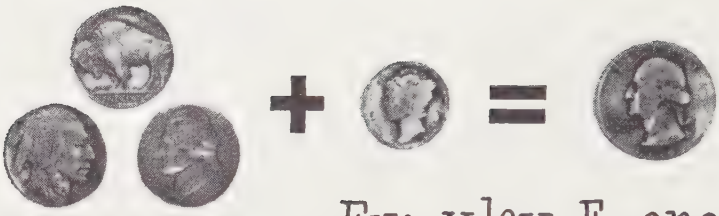
The election of Lincoln and the triumph of the upstart Republican party in 1860 made secession inevitable. Not only was the South a minority section, but now it had lost control of the federal government through the party system. Lincoln had run on a sectional platform that had as its central plank the limiting of the expansion of slavery. The Civil War marked a turning point in American economic history. The very resources that the South had lacked permitted the military victory of the North. The Union leaned heavily on its advantageous developments in manufacturing and transportation. It had a surplus of manpower and more ample sources of liquid capital. It was able to finance the war by creating a huge national debt, and though inflation was a problem, it was not nearly so severe in the North as in the South, where paper money brought disaster.

Furthermore, the war and the victory of the Union legitimized the very groups that the South had tried to check. Through independence, the South had hoped to protect slavery, end the onerous indirect trade, prevent the imposition of high tariffs and expand further southward. Yet, secession and war made it all the easier for the Northern economic community to satisfy its needs. With the South out of the Union, the war years marked the irrevocable triumph of a philosophy that favored the commercial and industrial development of the country.

High tariffs were enacted, federal aid was offered to transcontinental railroad companies, a national banking system replaced the system of state banks, a contract labor law was passed and farmers and city workers gained a watered-down version of the older homestead laws. The alliance between the Northern business community and the commercial farmers of the West was even more secure.

Ironically, the South's effort to protect slavery ended in slavery's destruction. The South wanted to preserve slavery; Lincoln and his followers wanted to preserve the Union. The Union was preserved by freeing the slaves, and the most vital revolution of all was wrought on "the Southern way of life." ■

NEXT MONTH: the post-Civil War boom in capital goods production



Everyday Economics

■ THE Federal Housing Administration now allows skipped payments on government-insured home mortgages. If you have made some payments in advance on this type of mortgage, you may be able to skip an equal number–should you get into financial difficulty at a later date. This is possible through mutual agreement between the lender and the borrower to waive monthly payments for a definite period. This arrangement applies only to the part of the payment that goes toward principal, insurance and taxes. Interest payments may not be postponed.

Easy entrance

IT IS now easier for an American firm to set up operations in Great Britain. Until recently, a foreign company was required to show that its activities would have a positive effect on the British economy, before the government granted it a license. Today, American firms no longer need to present any justification. Government approval is a mere formality, provided the firm accepts the same location requirements that apply to British companies.

Who pays?

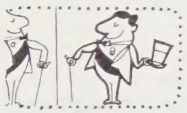
A MAN working in one state and living in another can apply to either for unemployment compensation, when he loses his job. But the state in which he built up work credits pays the benefits, no matter where the application was originally made. The amount of compensation is determined by the laws of the employing state.

Sources of capital

CONGRESS has authorized the Small Business Administration to license and help finance a new set of financial institutions, called Small Business Investment Companies. These organizations will furnish small firms with either new equity money or long-term loans for new capital investment.

An SBIC may be formed by a group of individuals or corporations, and is required to have a minimum capitalization of 300,000 dollars. Most of its funds will go to manufacturers with less than 250 employees, or wholesalers and retailers with annual sales under one million dollars. These companies will soon be set up in some of the larger metropolitan areas. Later they will be tried in rural sections.

Career dope



AN applicant who is eligible to take the Foreign Service Officer Examination must be between the ages of 20 and 31, and an American citizen for at least nine years. If he is married, his wife must also be a citizen at the time of appointment. The examination is usually given twice a year and consists of three parts: written, oral and physical. Exact dates and locations are announced by the State Department, and candidates must submit applications no later than six weeks before the exam date.

Duty free

IF YOU plan to fly back from Europe, you might stop over at a "tax-free" airport such as the Schipohl in Amsterdam, Orly Field in Paris, Kasturp Airport in Copenhagen or Shannon Field in Dublin to pick up some bargains. Shops there offer a wide variety of goods–French perfumes, Irish and French liquors, German cameras and Swiss watches at about half of U.S. prices. But there are limitations on the quantity of liquor or tobacco that may be brought back. Most airlines do not count small items as a part of baggage allowance. But if you can't take the merchandise with you, 24-hour postal service is provided at these airports.

Proper weight

MAKE AN at-home check of the weight of prepackaged meat, fruit and vegetable purchases. You may discover a significant difference from the label claim. Store managers believe that mistakes often occur in such items. Check the store itself. See that there are inspection markers on the store scales. There are stickers showing the last inspection date, or lead seals with wires to prevent tampering. You might watch out for these tricks: a scale above eye level so that it can't be read correctly, a ceiling fan above the scale to depress it an ounce or two, or a tilted scale that overweighs.–L.B.

The Supreme Court from Taft to Warren. Alpheus T. Mason. 250 pp. Baton Rouge: Louisiana State University Press. $4.95.

•Prof. Mason finds the Supreme Court with its robes ruffled but its principles firmly placed. His literate study ignores limitations set by legalistic formalism to inquire of the conscience of the judges and the standards they use. Mason disposes of the doubtful contradiction between the "pure" and "sociological" interpretations of the Constitution by showing that the social and political assumptions, whether admitted or denied, were always important. He offers a solution to the problem of federal powers: court acceptance of the extension of those powers in economic and social alleviation, court resistance to governmental infringement of civil rights. But he does not ask what happens when social measures conflict with the defense of civil rights. Approving contemporary court developments like the integration decision, Mason finds varying amounts of hypocrisy in past phases and appears unconcerned that a future student may shunt that praised present into a similarly condemned past. His approval extends, moreover, to an area deplored by extremer democrats: his conception of democracy sees no conflict between the principle of an appointive judiciary and active court participation in the governing process.

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Soviet Economic Aid. Joseph S. Berliner. 232 pp. New York: Frederick A. Praeger. $4.25.

•This is a competent study of the economic impact of the Soviet foreign aid program to underdeveloped areas. Prof. Berliner asks the obvious questions that bother the general reader for whom his book is clearly intended. His factual chapters on the size and distribution of Soviet aid programs are by far the best. Prof. Berliner stresses the selective character of Soviet aid which, unlike ours, is concentrated on capital development projects in a few countries. He warns against the easy assumption that the Soviet economy must suffer because of foreign aid commitments. In many ways, foreign aid will strengthen Russia in its drive for more capital goods production. It is when Prof. Berliner turns to the political implications that his book is disappointing. Certainly his assumption that the Soviet aid drive may have reached a "plateau," beyond which neither the Soviets nor the recipient countries are willing to go, is not justified by recent events. ■

Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Ten correct answers is Excellent; 9, Good; 8, Average. If you do the quiz *before* reading the articles, 6 correct answers is good. Answers on page 28.

(1) The Industrial Revolution initiated the use of child labor.

True ☐ **False** ☐

(2) Railroad securities are selling at a price far below book value.

True ☐ **False** ☐

(3) Keynes postulated a constant relation between investment and employment in his *General Theory.*

True ☐ **False** ☐

(4) Short-term government issues now constitute half of the marketable national debt.

True ☐ **False** ☐

(5) Unions are prohibited from purchasing stocks in companies with which they have collective bargaining agreements.

True ☐ **False** ☐

(6) Urban population in the U. S. has more than tripled since the turn of the century.

True ☐ **False** ☐

(7) Southern extremists advocated territorial expansion outside the U. S. during the 1850s.

True ☐ **False** ☐

(8) Since 1945, the rate of wage increases in unionized industries has been higher than in nonunionized industries.

True ☐ **False** ☐

(9) Sales and excise taxes account for 40 per cent of the federal government's income.

True ☐ **False** ☐

(10) Morale weakens automatically when danger increases.

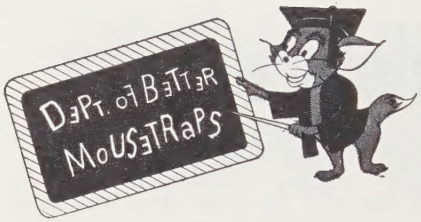
True ☐ **False** ☐

(11) Unemployment averaged seven per cent of the labor force in the first nine months of 1958.

True ☐ **False** ☐

(12) Olivetti transformed the artisan character of his firm after his Swiss exile.

True ☐ **False** ☐



Around the House: Holiday novelty candles that retain decorative shape as they burn . . . Enamel paint that dries in 15 minutes . . . A window that closes automatically when room temperature drops below a predetermined setting on the thermostat, when rain or snow falls, or when a strong wind blows . . . A storm-warning device that measures the intensity of atmospheric electrical discharges and indicates proximity of severe storms.

* * *

From the World of Industry: *A music typewriter that transcribes scores quickly and legibly . . . A feed-processing truck that comes to the farm, and with its hammer mill grinds grain and roughage into feed, then blends the feed with molasses and vitamin concentrates . . . Electronic earphones that shut out loud noises which interfere with communications during combat . . . Lightweight, acid-resistant, sand insulating material that can be used in lieu of firebrick to line furnace stacks or pipes subject to corrosion.*

* * *

Medical Highlights: Long-distance diagnosis of heart ailments will be possible with a transistorized unit that transmits heart sounds and electrocardiograph signals by telephone . . . A reading machine that will enable blind people to read ordinary printed matter by converting letters of the alphabet into distinct musical tones . . . An X-ray amplifier that magnifies an image 350 times; it also reduces the amount of radiation during examination . . . Electrodes that, when attached to the chest, stimulate faltering heartbeat without necessitating surgery.

* * *

Winter Sportsman: *Insulated underwear that reduces the need for bulky outer clothing . . . Your fingers won't be cold with a surf fishing rod that has a heated handle and attachable glove . . . A portable, alcohol-burning stove that can be used safely to warm a fisherman's chair when lid is placed over it; it also heats tents.*

* * *

Stocking Stuffers: The five market-going pigs that act out their famous rhyme when squeezed . . . An outer-space gun that discharges perfect smoke rings . . . A plastic space helmet that has molded-in goggles and revolving antennae . . . Hollow barbells that can be filled with water or sand to adjust their weights; weights can be varied from two to 20 pounds as junior intensifies his build-up program.

* * *

Personal Business: *Air-conditioned rubber boots that have built-in ridges to direct ventilation and circulation of air . . . Lensless plastic blinders that help bowlers avoid distraction from adjoining alleys . . . Matchbooks that adhere to cigarette packages, and contain 200 matches . . . A portable lap desk that has an adjustable steel bracket to fit comfortably around the knees; a clip holds papers firmly in place.*

* * *

Write to CHALLENGE magazine for additional information. ■